

Tennessee State Veterans' Homes Board

**For the Year Ended
June 30, 2002**

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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

February 12, 2004

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Tennessee State Veterans' Homes Board
345 Compton Road
Murfreesboro, Tennessee 37130

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee State Veterans' Homes Board for the year ended June 30, 2002. You will note from the independent auditor's report that a disclaimer was issued on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The board's management has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
03/034

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2002

AUDIT OBJECTIVES

The objectives of the audit were to consider the board's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

INTERNAL CONTROL FINDINGS

For the Sixth Consecutive Year, Accounts Receivable Practices Are Not Adequate**

The Tennessee State Veterans' Homes Board's accounts receivable balance still does not portray a complete picture of the current receivable activity or the true amount the board must attempt to collect. The board has not promptly refunded Medicaid overpayments. The board has not properly reduced the rate adjustment for certain Medicaid-eligible veterans, and there are several unexplained negative receivable balances (page 10).

Accounting Records Do Not Portray a True Picture of Receivables

The Tennessee State Veterans' Homes Board does not maintain adequate accounting records regarding receivables. The balances shown on the financial statements as well as the individual receivable balances for a number of past and present residents do not portray an accurate

picture of the amounts owed to the board (page 17).

For the Sixth Consecutive Year, Internal Control for Capital Assets Is Not Adequate**

Significant deficiencies continue to exist in internal control for capital assets. These deficiencies include an inability to correlate the results of physical inventories with accounting records, the failure to remove or investigate missing or surplus equipment, and incomplete policies and procedures. In addition, the board's assets may not be adequately insured (page 19).

Management Still Did Not Monitor the Activities of the Trustee and Did Not Maintain Internal Control Over Cash*

Management did not maintain internal control over cash. As a result, numerous errors occurred in the trust accounts and in the cash accounts on the general ledger (page 28).

Management Failed to Provide Adequate Documentation for the Audit Process

Management did not retain all documentation necessary for the audit process, resulting in a disclaimer of opinion on the financial statements (page 31).

Internal Controls for Information Systems Are Not Adequate

Few policies and procedures, either written or unwritten, relating to the information system are maintained. Also, controls regarding access to the system are weak (page 34).

Collection Efforts for Accounts Receivable Are Not Adequate

Written procedures to collect receivables are not followed and action taken to collect the receivables is not documented (page 37).

Internal Control for Purchasing Is Not Adequate**

The board facilities do not have an adequate segregation of duties relating to purchasing, the board's policies and procedures over purchasing are not being followed, and service contract

approvals required by state law are not being obtained (page 43).

Improper Employer/Employee Relationships and Potential Conflicts of Interest Were Noted

Improper employer/employee relationships between independent contractors and the Humboldt facility were noted. The hiring of the individuals as contractors circumvented the personnel policies related to conflicts of interest (page 45).

For the Fourth Consecutive Year, Receipt of Goods and Services Was Not Documented**

The verification of receipt was not consistently documented (page 47).

Petty Cash Policies Are Still Inadequate and Are Still Not Being Followed**

The petty cash policy does not address what types of purchases can be made through petty cash funds. The policies and procedures that have been adopted are not being followed (page 48).

COMPLIANCE FINDINGS

For the Sixth Consecutive Year, Accounts Receivable Practices Are Not Adequate**

The board has not promptly refunded Medicaid overpayments, and the management company has not properly reduced the rate adjustments for certain Medicaid-eligible veterans (page 10).

The Board Still Did Not Comply With Legally Binding Documents, Losing Control of Cash Flow*

The board has failed to meet all of the requirements within the Official Statements and other Bond Documents. Control of spending was circumvented when transfers were not made as set forth in the bond documents (page 24).

The Foundation Board Continues to Improperly Use Veterans' Homes Board Employees and Resources for Its Operations**

Employees of the board handle cash receipting and financial records for the foundation (page 39).

Travel Claims Again Were Not in Compliance With Comprehensive Travel Regulations, Resulting in Excessive Reimbursement of Over \$2,000*

Board members and employees of the facilities have not completed travel claims in accordance with Comprehensive Travel Regulations (page 40).

Five of the reportable conditions described above were considered material weaknesses:

- For the sixth consecutive year, accounts receivable practices are not adequate
- Accounting records do not portray a true picture of receivables
- For the sixth consecutive year, internal control for capital assets is not adequate
- Management still did not monitor the activities of the trustee and did not maintain internal control over cash
- Management failed to provide adequate documentation for the audit process

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. The material weaknesses regarding accounts receivable practices and the compliance finding regarding noncompliance with the bond documents also report material noncompliance.

* This finding is repeated from the prior audit.

** This finding is repeated from prior audits.

DISCLAIMER ON THE FINANCIAL STATEMENTS

Certain records and documentation supporting transactions and account balances were not available for our audit. Other records have not been adequately maintained. Therefore, we were not able to satisfy ourselves about the amounts at which cash, accounts receivable, furniture and equipment, and accounts payable are recorded at June 30, 2002, and the amounts of expenses and revenues for the year ended June 30, 2002. Because of the significance of these matters, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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Audit Report
Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2002

TABLE OF CONTENTS

	<u>Exhibit</u>	<u>Page</u>
INTRODUCTION		1
Post-Audit Authority		1
Background		1
Organization		2
AUDIT SCOPE		2
OBJECTIVES OF THE AUDIT		2
PRIOR AUDIT FINDINGS		4
RESULTS OF THE AUDIT		4
Audit Conclusions		4
Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>		6
Findings and Recommendations		10
Finding 1 - For the sixth consecutive year, accounts receivable practices are not adequate		10
Finding 2 - Accounting records do not portray a true picture of receivables		17
Finding 3 - For the sixth consecutive year, internal control for capital assets is not adequate		19
Finding 4 - The board still did not comply with legally binding documents, losing control of cash flow		24
Finding 5 - Management still did not monitor the activities of the trustee and did not maintain internal control over cash		28
Finding 6 - Management failed to provide adequate documentation for the audit process		31

Finding 7 - Internal controls for information systems are not adequate	34
Finding 8 - Collection efforts for accounts receivable are not adequate	37
Finding 9 - The foundation board continues to improperly use Veterans' Homes Board employees and resources for its operations	39
Finding 10 - Travel claims again were not in compliance with Comprehensive Travel Regulations, resulting in excessive reimbursement of over \$2,000	40
Finding 11 - Internal control for purchasing is not adequate	43
Finding 12 - Improper employer/employee relationships, and potential conflicts of interest were noted	45
Finding 13 - For the fourth consecutive year, receipt of goods and services was not documented	47
Finding 14 - Petty cash policies are still inadequate and are still not being followed	48

FINANCIAL SECTION

Independent Auditor's Report	51
Financial Statements	53
Unaudited Statement of Net Assets	A 53
Unaudited Statement of Revenues, Expenses, and Changes in Net Assets	B 55
Unaudited Statement of Cash Flows	C 57
Unaudited Notes to the Financial Statements	59
Required Supplementary Information	71
Unaudited Schedule of Pension Funding Progress	71
Other Supplementary Information	72
Unaudited Supplementary Statements of Net Assets	72
Unaudited Supplementary Statements of Revenues, Expenses, and Changes in Net Assets	74
Unaudited Supplementary Statements of Cash Flows	76

Tennessee State Veterans' Homes Board For the Year Ended June 30, 2002

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee State Veterans' Homes Board. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The Tennessee State Veterans' Homes Board was established in 1988 under the provisions of Title 58, Chapter 7, *Tennessee Code Annotated*. This statute authorizes the creation of public homes for veterans throughout the state to provide support and care for honorably discharged veterans who served in the United States armed forces. The board operates two facilities—one in Murfreesboro and one in Humboldt—and has plans to build a third facility in East Tennessee. The board has the authority to employ an executive director and other employees; to incur expenses as may be necessary for the proper discharge of the board's duties; to establish policies regarding the rates for patient care in a state veterans' home; and to incur debts, borrow money, issue debt instruments, and provide for the rights of the holders of the debt instruments.

The board consists of ten members. The Commissioner of the Tennessee Department of Veterans Affairs serves *ex officio* as a voting member of the board. The remaining nine members are appointed by the Governor, three from each of the three grand divisions of the state. The Governor appoints a member of the board to serve as chairman. Each board member must be a citizen of the state and an honorably discharged veteran.

ORGANIZATION

As of November 1, 1994, the board contracted with ServiceMaster Diversified Health Services, L.P., (Diversified) to manage both the financial and clinical operations of the Murfreesboro facility as well as those of the Humboldt facility upon its opening. This subsidiary of ServiceMaster was purchased by the Forest Hill Group on September 1, 2000, and was renamed BEP Services. On May 31, 2001, the Forest Hill Group filed for reorganization of the company under Chapter 11 of the Bankruptcy Code. In August 2001, the board was informed that BEP Services would no longer be providing long-term care services. The board contracted with National HealthCare Corporation (NHC) as of December 1, 2001. BEP Services provided no services for either facility after January 31, 2002.

The management company employed an Administrator to oversee daily operations of each facility. The Administrator then hired the managerial staff including the Director of Nursing, Business Office Manager, Director of Medical Records, Director of Social Services, Food Services Manager, Activities Coordinator, Housekeeping Superintendent, Maintenance Supervisor, and all other facility employees. Although these employees were hired by the Administrator from the management company, they were employees of the board. As of January 1, 2003, NHC began serving in the role of consultant to the board. At this time, the Administrators became employees of the board.

An organization chart for the Tennessee State Veterans' Homes Board is on the following page.

AUDIT SCOPE

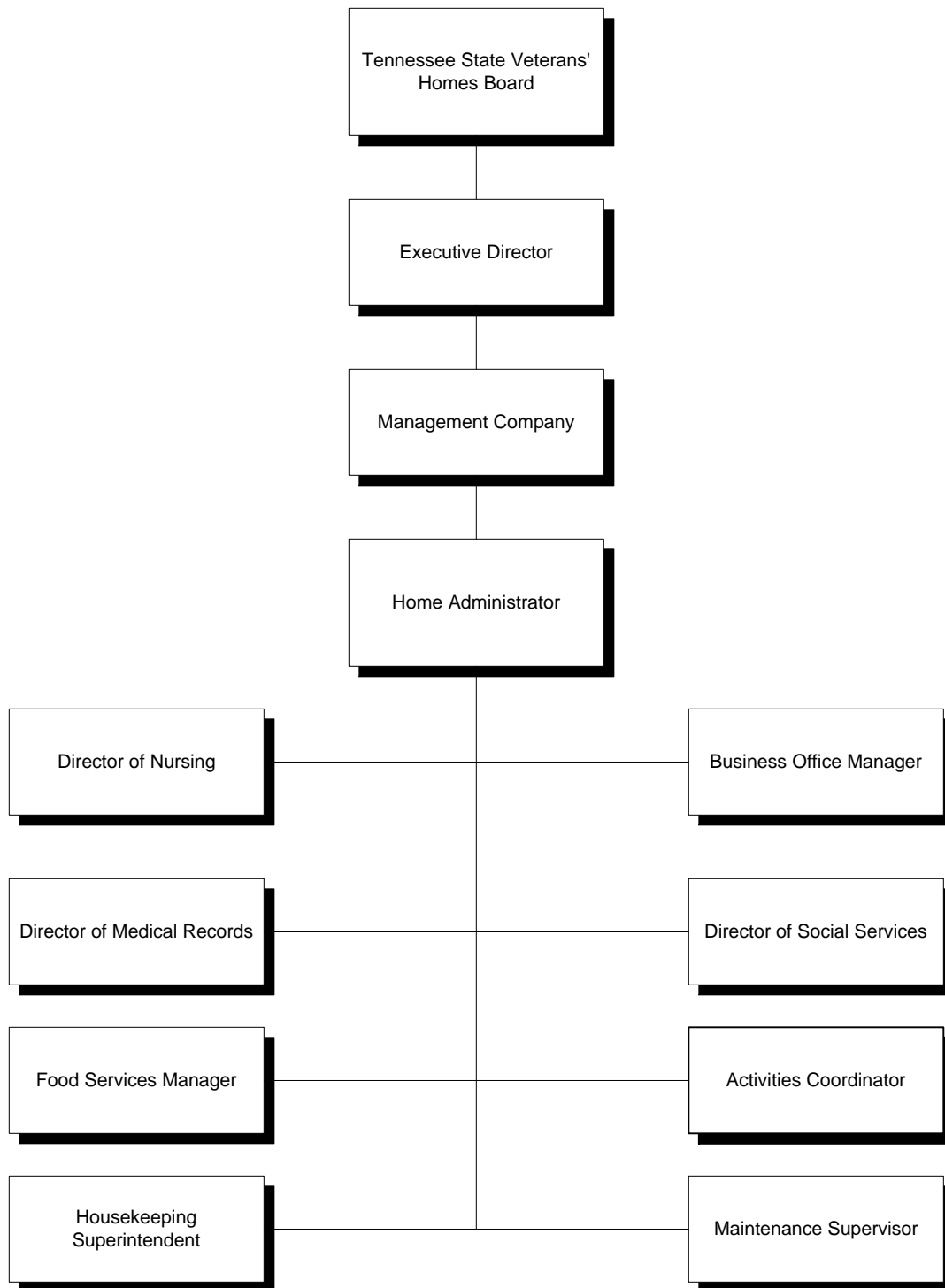
The audit engagement was limited to the period July 1, 2001, through June 30, 2002. The Tennessee State Veterans' Homes Board has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the board's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;

TENNESSEE STATE VETERANS' HOMES BOARD



2. to determine compliance with certain provisions of laws, regulations, and contracts;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The board filed its report with the Department of Audit on September 10, 2003. A follow-up of all prior audit findings was conducted as part of the current audit.

REPEATED AUDIT FINDINGS

The prior audit report contained findings concerning accounts receivable practices and controls over equipment, compliance with legally binding documents, monitoring the trustee and recording cash entries, compliance with Comprehensive Travel Regulations, purchasing, petty cash receipting, receipt of goods and services, and the foundation. None of these findings have been resolved and each finding is repeated in this report.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee State Veterans' Homes Board's financial statements for the year ended June 30, 2002, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Material weaknesses and other reportable conditions, along with recommendations and management's responses, are detailed in the findings and recommendations.

Compliance

The results of our audit tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*. These instances of material noncompliance and other instances of noncompliance, along with recommendations and management's responses, are included in the findings and recommendations.

Fairness of Financial Statement Presentation

The Division of State Audit has disclaimed an opinion on the Tennessee State Veterans' Homes Board's financial statements. Certain records and documentation supporting transactions and account balances were not available for our audit. Other records have not been adequately maintained. Therefore, we were not able to satisfy ourselves about the amounts at which cash, accounts receivable, furniture and equipment, and accounts payable are recorded at June 30, 2002, and the amounts of expenses and revenues for the year ended June 30, 2002. Because of the significance of these matters, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements.



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT**

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**Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

July 11, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We were engaged to audit the financial statements of the Tennessee State Veterans' Homes Board, a component unit of the State of Tennessee, as of and for the year ended June 30, 2002, and have issued our report thereon dated July 11, 2003. We did not express an opinion on the financial statements because certain records and documentation supporting transactions and account balances were not available for our audit and other records have not been adequately maintained.

Compliance

As part of obtaining reasonable assurance about whether the board's financial statements are free of material misstatement, we performed tests of the board's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly,

we do not express such an opinion. The results of our tests disclosed the following instances of noncompliance that are required to be reported under *Government Auditing Standards*.

- Medicaid overpayments are not refunded promptly, and certain Medicaid rate adjustments have not been properly reduced
- The board still did not comply with legally binding documents, losing control of cash flow

These instances of noncompliance are described in finding 1 and finding 4 of the Findings and Recommendations section of this report.

We also noted certain other instances of noncompliance that we have included in the Findings and Recommendations section of this report.

- The foundation board continues to improperly use Veterans' Homes Board employees and resources for its operations
- Travel claims again were not in compliance with Comprehensive Travel Regulations, resulting in excessive reimbursement of over \$2,000

Less significant instances of noncompliance have been reported to the board's management in a separate letter.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the board's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable conditions were noted:

- For the sixth consecutive year, accounts receivable practices are not adequate

- Accounting records do not portray a true picture of receivables
- For the sixth consecutive year, internal control for capital assets is not adequate
- Management still did not monitor the activities of the trustee and did not maintain control over cash
- Management failed to provide adequate documentation for the audit process
- Internal controls for information systems are not adequate
- Collection efforts for accounts receivable are not adequate
- Internal control for purchasing is not adequate
- Improper employer/employee relationships and potential conflicts of interest were noted
- For the fourth consecutive year, receipt of goods and services was not documented
- Petty cash policies are still inadequate and are still not being followed

These conditions are described in the Findings and Recommendations section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider the following to be material weaknesses:

- For the sixth consecutive year, accounts receivable practices are not adequate
- Accounting records do not portray a true picture of receivables
- For the sixth consecutive year, internal control for capital assets is not adequate

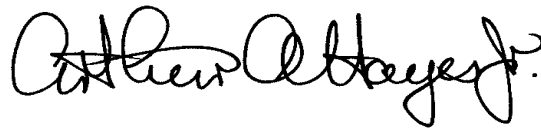
The Honorable John G. Morgan
July 11, 2003
Page Four

- Management still did not monitor the activities of the trustee and did not maintain internal control over cash
- Management failed to provide adequate documentation for the audit process

We also noted other matters involving the internal control over financial reporting which we have reported to the board's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the board of directors, and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

A handwritten signature in black ink, appearing to read "Arthur A. Hayes, Jr.", with a stylized flourish at the end.

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

FINDINGS AND RECOMMENDATIONS

1. For the sixth consecutive year, accounts receivable practices are not adequate

Finding

As reported in the prior five audits, the Tennessee State Veterans' Homes Board's accounts receivable balance still does not portray a complete picture of the current receivable activity or the true amount the board must attempt to collect. The board has not promptly refunded Medicaid overpayments. The board has not properly reduced the rate adjustments for certain Medicaid-eligible veterans, and there are several unexplained negative receivable balances not associated with the Medicaid overpayments or rate adjustments for Medicaid-eligible veterans.

The board concurred with the prior finding regarding the rate adjustments. They stated that manual contractual adjustments through the Medicaid contractual adjustment account would eliminate the rate adjustment problem. Although the board appears to be making adjustments as needed for current activity, there are still old credit balances created by the problem that need adjustment. The board did correct other previous issues related to the allowance for doubtful accounts and recording of revenue.

The board did not concur with the prior findings regarding Medicaid overpayments not being refunded promptly, repayment of prior Medicaid balances, and other credit balances for Medicaid-eligible residents. The board stated that void adjustments could not be processed within the required time period. However, review of the multiple void adjustments that were processed timely shows that this statement was not accurate. Still, the Humboldt facility has not been processing void adjustments timely. As far as the funds recommended for repayment related to prior periods, the board indicated that it requested the Governor's review of this issue. As discussed later in this finding, the board has implicitly recognized its liability to the Medicaid program through its actions. In addition, at the board's request, the Commissioner of the Department of Health previously researched the issues raised by the board and responded to the board on October 14, 1997, that the \$282,062.42 was "due and payable to the TennCare [Medicaid] program." If the Governor chooses to release the board from this obligation, the state will still be responsible for refunding the federal percentage to the U.S. Department of Health and Human Services. Regarding the credit balances, the board stated that the process of collecting, adjusting, and refunding these credit balances will take a "substantial amount of time" and that the facilities would research the balances as time and staff permit. The board has not made the resolution of this finding a priority and has still not made progress in this area.

Background

All residents of a board facility are charged a standard rate for each day that they reside in the facility. To meet these charges, a resident may be eligible for assistance from Medicaid if the resident is both medically and financially eligible. Assistance from the Medicaid program consists of both a contractually established reduction in the standard rate (to the "Medicaid rate")

and assistance payments from the U.S. Department of Health and Human Services via the Tennessee Department of Finance and Administration. Formerly, these payments came through the Tennessee Department of Health. In assessing a resident's financial eligibility for Medicaid assistance, the resident's ability to contribute to his or her cost of care is evaluated. The resident's calculated contribution to his or her cost of care is referred to as the patient liability amount. Many Medicaid-eligible residents have limited sources of income and may have no patient liability, or the amount may be very minimal.

For example, assume the standard rate is \$92 per day, and the Medicaid rate is \$80 per day. The resident's account would typically be charged the standard rate of \$92, and if the resident were eligible for Medicaid assistance, the account would then be reduced by \$12 to equal the Medicaid rate. If the Medicaid-eligible resident has a calculated patient liability amount of \$10, this amount would be collected from the resident, and the Medicaid program would pay the difference of \$70.

In addition, veterans are eligible for reimbursement from the U.S. Department of Veterans Affairs (VA) for each day they reside in a Tennessee Veterans' Home facility. This per diem amount is used to offset the veteran's costs before any other assistance resources are applied. The per diem is not income to the veteran, and therefore is appropriately not considered in calculating a veteran's financial eligibility for Medicaid assistance and is not a contribution toward the calculated patient liability amount.

Medicaid overpayments are not refunded promptly

In the example above, if the VA per diem amount were \$40, the resident's receivable account would be overcollected by \$40 as shown below.

<u>Activity in Receivable Account</u>	<u>Total</u>	<u>Cumulative Total</u>
Standard rate	\$92	\$92
less the adjustment to reduce the standard rate to the Medicaid rate of \$80	12	80
less the patient liability payment	10	70
less the Medicaid assistance payment	70	0
less the VA per diem payment	40	(40)
is equal to a credit balance (or overcollection) in the receivable account	<u>(\$40)</u>	<u>(\$40)</u>

If a veteran is eligible for Medicaid assistance, the Medicaid assistance payment to the facility must be reduced by the VA per diem amount. (Medicaid is considered the payer of last resort.) The Tennessee State Veterans' Homes Board has not promptly reduced the veteran's Medicaid assistance payment and refunded the current overpayments to Medicaid (estimated to be \$550,523.83 at June 30, 2002) and has not repaid \$282,062.42 due to the Medicaid program for overpayments occurring before 1994.

The Division of Medicaid, General Rule 1200-13-1-.04, subsection (2) (a) (1) of *Rules of the Tennessee Department of Health*, states,

If third party payment is less than the Medicaid allowable, Medicaid will pay the difference between the third party payment and the Medicaid allowable. No further claim shall be allowed against the recipient and/or the recipient's responsible party(s) for Medicaid services.

After an audit finding reported by the Comptroller's Office in the June 30, 1992, audit report, the Department of Health established a mechanism for the board to refund the excess Medicaid assistance payments received by filing a "void adjustment" after both the VA per diem and Medicaid assistance payments are collected. Although the mechanism is cumbersome (a separate void adjustment must be filed on every veteran for every month that Medicaid assistance payments are received), it appears to accomplish the objective of returning the excess funds to the Medicaid program.

The Murfreesboro facility began processing void adjustments to return overpayments to the Medicaid program in 1993. When the Humboldt facility opened in February 1996, it was tentatively instructed by the Department of Health not to implement the void adjustment process at that time. Subsequently, the facility received a letter from the Commissioner of the Department of Health dated October 14, 1997, stating,

. . . the procedures currently in place at the Murfreesboro facility should now be used by the Humboldt facility each month in order to minimize an outstanding liability in the future. All documentation for residents at the Humboldt facility since its opening should now be sent to the TennCare Bureau along with the corresponding payments.

The facility did not comply with this instruction until February 1998. At that time, the Executive Director instructed the facility to begin a monthly repayment process by submitting the current month's void adjustments and two to three of the oldest months' void adjustments. This procedure was to continue until the entire amount was repaid. The facility prepared the specified void adjustments in February but subsequently failed to systematically follow up with additional void adjustments. In February 1999, the facility began preparing void adjustments on a monthly basis. However, the adjustments are not timely. Five of 19 residents requiring adjustments in Humboldt (26%) did not receive timely void adjustments. According to Section 1200-13-1-.04, subsection (3), Rules of the Tennessee Department of Health, "Providers receiving third party payments following Medicaid payment shall notify and refund Medicaid within 60 days of receipt of the third party payment. The refund to Medicaid shall be the lesser of the third party or Medicaid payment."

In addition, many void adjustments from the previous months were not yet processed. When the VA per diem and the Medicaid assistance payments have both been received and the void adjustments have not been processed, the veteran's receivable account has been overcollected and therefore has a negative or "credit" balance. The facilities still have significant credit balances related to prior periods. Of the estimated \$550,523.83 in outstanding void adjustments, only \$167,122.52 appears to relate to the most recent six-month period.

Before the implementation of the void adjustment process, the Department of Health did not have an established mechanism for the board to return excess Medicaid funds. On December 25, 1992, and April 16, 1993, \$178,856.42 and \$23,109.57, respectively, were withheld from Medicaid payments to the board. These amounts were deductions from the total amount due to the board and were not attributed to specific residents. Evidently, these amounts were withheld based on communication between the Department of Health and the board's Executive Director at that time. The amount due to the Medicaid program attributable to the dates of service between the opening of the Murfreesboro facility in 1991 and the inception of the void adjustment process in 1993, net of the two repayments mentioned above, is \$282,062.42. This amount is recorded on the board's financial statements as a payable to the Department of Health, and the auditors have indicated to management in the past several audits that repayment to the department should be addressed.

Although the board has implicitly recognized its liability to the Medicaid program through its actions, beginning with the two repayments mentioned above, the board has questioned whether these monies are actually due back to the Medicaid program. A meeting was held with Department of Health staff, Veterans Affairs staff, Comptroller's staff, and representatives from the Tennessee State Veterans' Homes Board. Concerns were heard from the board members, and the Department of Health staff agreed to research the possibility of regulations that might eliminate the balance due to the Medicaid program.

After researching the issues raised by the board, the Commissioner of the Department of Health responded to the board on October 14, 1997. The Commissioner cited Section 4055.80 of the *Medicare and Medicaid Guide* as quoted above and requested "payment of the \$282,062.42, which has been determined due and payable to the TennCare [Medicaid] program." This repayment has not yet been made.

Certain Medicaid rate adjustments have not been properly reduced

Although most Medicaid-eligible veterans have a minimal patient liability amount, some have a more substantial patient liability amount. When the VA per diem amount is combined with a more substantial patient liability amount, the total may exceed the Medicaid rate. When the Medicaid rate is exceeded, the resident's accounts receivable balance becomes negative, effectively reflecting an overpayment in the resident's account, when there is no overpayment due to the resident.

In the example cited previously, if the Medicaid-eligible veteran has a patient liability amount of \$48 instead of \$10, the activity in his receivable account is as follows:

<u>Activity in Receivable Account</u>	Total	Cumulative Total
Standard rate	\$92	\$92
less the adjustment to reduce the standard rate to the Medicaid rate of \$80	12	80
less the patient liability payment	48	32
less the VA per diem payment	40	(8)

(the Medicaid program is not billed for an assistance payment)	<u>0</u>	<u>0</u>
is equal to a credit balance (or overcollection) in the receivable account	<u>(\$8)</u>	<u>(\$8)</u>

The VA per diem amount is a fixed amount for all veterans. The patient liability amount is established in the Medicaid eligibility process and represents an amount that the patient can reasonably be expected to pay. Therefore, the only amount that can be reduced to prevent the “overpayment” is the adjustment that reduces the standard rate to the Medicaid rate. The adjustment should equal the difference between the standard rate, the patient liability amount, and the VA per diem amount, leaving the resident’s account with a zero balance. In the example above, the adjustment should be reduced to \$4 instead of \$12. Because this calculation could be different for each veteran resident with a more substantial patient liability amount, the management company’s accounts receivable system cannot automatically perform the calculation and make the reduction to the adjustment amount. Although the system now identifies the accounts needing adjustment and staff appear to be correcting the adjustments identified, a review of the aging report showed amounts from prior periods still requiring adjustment. When the receivable balance from the old management company was transferred to the new management company, detailed information within each payor source was not retained, making it impossible to distinguish between the amount of the prior credit balances related to this issue and the credit balance related to void adjustments or other issues. However, an overall credit balance of \$557,820.03 still exists for Humboldt, and a credit balance of \$251,524.42 still exists for Murfreesboro.

Numerous other credit balances exist for Medicaid-eligible recipients

In past years, we have identified other credit balances of \$59,526.68 for Humboldt and \$77,850.75 for Murfreesboro. The board could not provide documentation that these balances were adjusted. As mentioned previously, overall credit balances of \$557,820.03 and \$251,524.42 still exist for the facilities. These balances must be researched and resolved.

Conclusion

Without promptly refunding Medicaid overpayments recorded as payments on behalf of the residents and without properly reducing certain Medicaid rate adjustments to the residents’ accounts, the residents’ subsidiary accounts have an inappropriate negative or “credit” balance incorrectly reflecting that refunds are due to those residents. As the credit balances grow in number and amount, the total accounts receivable balance becomes more distorted, and financial decision making or monitoring may be affected. Credit balances are included in total accounts receivable, causing the receivable balance on the board’s monthly financial statements to appear to be lower than the amount the board actually must attempt to collect.

Recommendation

The Executive Director should make a serious attempt to resolve these issues. Because of the unique nature of the operations and funding structure within a veterans’ facility, a

standardized computer accounting system may not be able to accommodate all types of accounts receivable transactions. Additional effort is necessary to manually process certain accounts receivable transactions. The board should carefully evaluate the accounts receivable practices. Any necessary policies and procedures should immediately be developed, documented, and implemented. The policies and procedures should ensure that void adjustments are routinely processed to refund overpayments of Medicaid assistance within 60 days of receiving the VA per diem. The policies and procedures should also establish adequate accounting practices to prevent the recording of “overpayments” of accounts receivable from excessive Medicaid rate adjustments for veteran residents with substantial patient liability amounts. The Executive Director should carefully supervise operations to ensure compliance with the policies and procedures.

The Tennessee State Veterans’ Homes Board should immediately refund the \$282,062.42 due to the Medicaid program for overpayments occurring before the void adjustment process began. In addition, the board should ensure that outstanding void adjustments for overpayments are processed timely and revenue is recorded appropriately. If additional manual processing of certain transactions is required, the board should ensure that sufficient staff is available and adequately trained to perform these functions. With the impending implementation of a new computer system, the board should immediately dedicate the resources necessary to get the old credit balances resolved.

The Tennessee State Veterans’ Homes Board should take appropriate measures to review the actions of the staff, determine whether sufficient attention has been directed toward resolving these discrepancies, and take appropriate action if these conditions do not improve.

Management’s Comment

Medicaid overpayments are not refunded promptly

We still do not concur that void adjustments can be routinely processed to refund overpayments of Medicaid assistance within 60 days of receiving the VA Per Diem. The VA Subsidy payment (third party payment) is received the month following the month services are provided. However, the Medicaid payment is not received until approximately one month after the VA Subsidy is received. Third party payments for most facilities are received after Medicaid payments are received, allowing more time for processing. Additionally, most facilities process approximately twenty void adjustments per month. Each of the TSVH processes approximately forty void adjustments per month. The Tennessee State Veterans’ Homes bill the Veterans Administration for per diem payments by the 10th of the month following dates of service. The Tennessee State Veterans’ Homes bill Medicaid via the Turnaround Document for Level I Medicaid residents by the 5th day of the month following dates of service. The Veterans Administration payment is typically received in about two weeks after billing. Medicaid then processes payment via a Remittance Advice. For example, January dates of service are billed by February 5th. The Remittance Advice showing the January claims being processed should be received from the Department of Human Services before the end of February. Next, the

Tennessee State Veterans' Homes file Adjustment Request Forms (Void Adjustments) within sixty days after receipt of the Medicaid Remittance Advice for each veteran on Medicaid that received a per diem payment from the Veterans Administration. Compliance is measured by comparing the Medicaid Remittance Advice receipt date with the date on the Adjustment Request Form. In the absence of a receipt date on the Remittance Advice, the Remittance Advice date plus two days is used as the receipt date. For Level II, the Tennessee State Veterans' Homes indicate Veterans Administration per diem payment on the UB92 Form when it is filed. The old credit balances are processed concurrently with current credit balances. The Tennessee State Veterans' Homes process current Void Adjustments plus an amount of old credits balances up to the projected Medicaid payment for the following month. The Board is in the process of finding a financial management system that will assist in the processing of the action.

We concur that old credit balances should be researched and adjusted. This will require the employment of additional staffing. These staff members will be hired immediately and all efforts will be made to resolve these accounts before conversion to the new accounting system.

We do not concur with the recommendation that the Board should immediately direct the Management Company to refund the \$282,062.42 for overpayments occurring before the void adjustment process began. The Board has requested in writing that the Governor review this issue. We have not received a response.

Certain Medicaid rate adjustments have not been properly reduced

We concur. The problem still exists for accounts from prior periods. Accounts from prior periods, is understood to refer to accounts managed by Service Master, Diversified Health Services, which later became BEP. This company went bankrupt and ceased being our management company in December, 2001. Up until that time much of the financial paper documents were maintained by the BEP. Records returned to the managed homes by the BEP were incomplete. Some records were sent to other homes and some were just lost. The TSVHB is currently seeking compensation for damages through a performance Bond carried by the management company as required by the management contract. As to the TSVHB efforts to reconcile these accounts from prior periods, the priority for both homes is to keep current, current. The existing staff is consumed with the day to day process of billing, collecting and recording accounts receivable. Both homes have hired temporary help to work on accounts which should have been kept up under BEP. The poor quality of record keeping plus the absence of many records complicates this process. Very little of the accounts from prior periods has been processed.

We concur that old accounts should be researched and adjusted. This will require the employment of additional staffing. These staff members will be hired as soon as possible and all efforts will be made to resolve these accounts before conversion to the new accounting system.

Numerous other credit balances exist for Medicaid-eligible recipients

We concur. Please see the response above.

Auditor's Rebuttal

The response to the lack of prompt refunding of Medicaid overpayments is the same response that management provided for the previous audit report. Our response, as in the prior report, is that as management described, the VA per diem payment is received approximately two weeks after the billing, which would be the 24th of the month subsequent to the service received. Management also stated that the Remittance Advice is received before the end of the month subsequent to the service received, and that the void adjustment is processed within 60 days of receipt of that remittance advice. To say that void adjustments cannot be processed within 60 days of the receipt of the per diem payment which is so close to the date of the receipt of the remittance advice is contradictory. Also, during current year testwork, each Murfreesboro void adjustment reviewed was processed in a timely manner, thus demonstrating that the time frame is reasonable. However, to take the board's comments into consideration, when errors were noted, we also reviewed the related remittance advice to determine if the adjustment was made 60 days after the remittance advice receipt date. For one of the five noted, the void adjustment was not processed timely regardless of the beginning date used. For the other four errors noted, staff could not locate the adjustment request form or the remittance advice showing that the void adjustment occurred. We examined every remittance advice from March 2002 through December 2002, and void adjustments never occurred for any of the four noted individuals.

In addition, although the board does not concur that the Medicaid overpayments resulting from the VA per diem payments should be refunded to the Medicaid programs, as discussed in the finding, the board has implicitly recognized this liability since December 25, 1992, when the first funds were withheld from a Medicaid payment to the board. The board has continued to recognize this liability by reporting a payable each year in the financial statements and by routinely processing void adjustments. Although a TennCare staff member has offered to help the board work to resolve the issue, the board has not chosen this option and continues to wait for a response to their request to the Governor's office, the first of which was made in February of 1999.

2. Accounting records do not portray a true picture of receivables

Finding

The Tennessee State Veterans' Homes Board does not maintain adequate accounting records regarding receivables. The balances shown on the financial statements as well as the individual receivable balances for a number of past and present residents do not portray an accurate picture of amounts owed to the board.

The Tennessee State Veterans' Homes Board offers a place of residence and medical care for veterans or spouses of veterans in the State of Tennessee. The board is compensated for these services by several different sources. Medicare, Medicaid, Veterans Affairs, private insurance companies and the residents themselves are all major payor sources for the board. As noted in finding 1 of this report, the board has had problems for several years concerning a large amount of credit receivables that are on the books. In addition, the board has a lot of old receivable balances that have not been collected or written off and are included in the allowance for doubtful accounts. The conversion to a new management company in January 2002 compounded these problems. When the conversion was made from the old management company ledgers to the new management company ledgers, any receivable amount that existed as of December 31, 2001, was placed into a separate general ledger account titled "Accounts Receivable Prior." This account was established without taking the necessary time to research the details of the amounts being placed into it. Before receivables can be turned over to the collection agency, each amount must be researched to determine if the receivable is valid and to adjust out any erroneous credits. Due to the time requirements related to the research, old accounts are not being turned over to the collection agency and remain on the books. In addition, certain cost report receivables and payables that were recorded in the old management company's ledger were added to the new management company's ledger without research. These accounts have been untouched even though, over time, it has become clear that the receivables and payables are no longer valid.

Receivable balances for the different payor sources (private, Medicaid, Medicare, VA, private insurance) at June 30, 2002, may not be representative of actual amounts owed to the board. In addition to the "Accounts Receivable Prior" account having unresolved credits, it was noted that occasionally the new management company's system incorrectly records charges for residents. The receivable is sometimes set up in the wrong payor source. When the payment related to the receivable arrives, the payment is then recorded to the correct payor source. This results in an overstated receivable for one payor source and an understated receivable or a credit balance for the other payor source. It also causes a receivable for a particular payor source to still exist when the payment was already received. Manual adjustments are then needed to correct this, but they are not always made. Due to these situations, the staff is not able to tell easily whether or not a certain payment has been received.

In some cases, the staff is not able to provide documentation that the payor source has been billed. During testwork, we noted that 7 of 26 Medicaid residents reviewed at Humboldt for March 2002 (7%) and 1 of 45 Medicaid residents reviewed at Murfreesboro for March 2002 (2%) had Medicaid receivables that were not billed or received. The charges were related to March 2002 and had not been received as of June 2003. Given the Medicaid time requirements for submitting claims, it does not appear likely the homes will be able to recoup unbilled amounts.

Also, when individuals call the board to see what they owe, staff is not able to provide an accurate amount in a reasonable time period. The staff would have to take the time to research each individual account through several old management company aging reports, some of which are no longer available, as well as the different reports produced by the current system to ensure that charges and payments were entered correctly. According to staff, each individual receivable

takes at least four hours to research. This takes valuable time but, when not performed, may result in communication of incorrect information or the loss of an opportunity to collect outstanding funds.

Recommendation

The Executive Director should assign staff specifically to this task to take the necessary time to research each resident's account that has any type of balance in the aging reports and make sure that the amounts are accurate. If available staff cannot take the time to do this needed research, the Executive Director should bring in additional help to rectify this problem. The board anticipates changing computer systems during the year ended June 30, 2004. All accounts should be researched and resolved before addition to the new accounting system. The Executive Director should ensure this research is done immediately so that the accounts can be submitted to the collection agency. The new accounting system should be designed to flag inappropriate entries and unresolved billings. The system should have information available and easily accessible by staff to answer simple billing questions so personnel can efficiently perform their duties. Accounts receivable policies and procedures should include a periodic review of all credit balances as well as a review of all resident accounts to ensure receivables are properly stated. With the board's intention to become self-managed and their desire to acquire another accounting system, the need to remedy this situation becomes extremely important.

Management's Comment

We concur that old accounts should be researched and collected or written off. This will require the employment of additional staffing. The Board estimates it will require three additional people to conduct the proper research of each resident's account and make the proper adjustments. These staff members will be hired immediately and all efforts will be made to resolve these accounts before conversion to the new accounting system. Doubtful accounts will be turned over to the contracted collection agency. The new accounting system will have easily accessible information to answer billing questions. Accounts receivable policies and procedures were implemented in July of 2003 implementing a periodic review of all credit balances as well as a review of all resident accounts to ensure receivables are properly stated. Adjustments are being submitted to the management company for correction.

3. For the sixth consecutive year, internal control for capital assets is not adequate

Finding

Significant deficiencies continue to exist in internal control for capital assets. These deficiencies include an inability to correlate the results of physical inventories with accounting records; the absence of property tags on the equipment items; inaccurate equipment listings; donated items that are not recorded on equipment listings or accounting records; the failure to

remove or investigate lost, stolen, cannibalized, or obsolete equipment; the absence of board-approved policies and procedures for determining the useful life of an item; the failure to properly surplus equipment items; a lack of proper approvals for adjustments to the accounting records; and incomplete policies and procedures for capitalizing equipment. In addition, as a result of these problems, the board's assets may not be adequately insured.

Similar deficiencies have been reported in prior findings in the last five audit reports. Management has concurred with the previous findings and recommendations and indicated that corrective action would be taken. Management stated that a reconciliation would be performed and that the property tag numbers would be included on the management company's capital asset listing. However, this reconciliation was not done, and the property tag numbers are still not included on the Depreciation Expense Report. They also stated that the property officer would notify the management company, in writing, when capital assets are lost, destroyed, or salvaged through the state and that donated property would be recorded in the same manner. Instances of donated property not being recorded were still being noted. Also, since there were no deletions from the property records even after a large surplus of equipment, it appears that the management company was still not properly being informed regarding surplus equipment. Management also stated that the capitalization policy would be clarified for capitalization procedures and valuation of property additions. The policy still does not address these issues. Finally, they stated that unused and unneeded equipment would be disposed of every 90 days. There was no evidence that this was being done. As these changes have not been made, little has been done to eliminate the deficiencies in internal control for capital assets.

Capital asset records continue to be inadequate. The current record keeping system does not allow for a reconciliation between the physical inventories taken at the facilities and the accounting records maintained. In the physical inventory records, the main identifying feature is the property tag number. The accounting records for capital assets maintained include a description, asset number, cost, acquisition date, and depreciation. The asset number is not the same as the property tag number. The only shared attribute between the inventory records and the capital asset records is the description. Because of the generic nature of the descriptions, reconciling the two listings would include a great deal of guesswork. In addition, many items do not have property tags. During an auditor observation, 29 of 230 equipment items observed (13%) did not have a property tag attached. Furthermore, the property officer at Murfreesboro was observed placing tags on items throughout the facility during the auditor equipment verification.

Testwork was performed to observe a sample of equipment items listed on the management company's capital asset records. Because of the lack of property tag numbers on management company records, it was impossible to positively identify any of the items that were sought; however, items that met the description listed were identified, with the following exceptions. At the Humboldt facility, 38 carts were counted when the listing included only 21; 8 wingback chairs were counted when the listing included 15; 5 broad chairs were counted when the listing included only 3; and 2 ranges were counted when the listing included 3. Per discussion with board personnel, one range was destroyed after a new one was purchased, but the old one was not removed from the property records. At the Murfreesboro facility, 10 of 62 Amherst mirrors could

not be located. Per discussion with board personnel, several of these mirrors were broken, but were never replaced or removed from the listing. Computata software costing \$16,000 was also on the listing; however, no computer with this software could be found. Per discussion with board personnel, this software was the package used by the former management company and was removed during the management company transition. One item described on the listing as a handgrip could not be located as board personnel could not give any description of the item or its uses. In addition, at Murfreesboro, 3 ice makers were counted when the listing included 4; 14 recliners were counted when the listing included 38; and 67 carts were counted when the listing included only 35. There were also items that were observed that clearly were outdated or broken but were not removed from the property listing.

As the description of the items is the only shared attribute, it is vital that this information is correct. However, during additional audit work, it was noted that this is not always the case. Two instances at Murfreesboro were noted where items described as “Recliner” were actually two recliners, according to the invoice. Another item at the Murfreesboro facility was included on the capital asset listing as “Recliners.” However, according to the prior year depreciation schedule, this item was a freezer. An item with the description of “Chairs” on the Humboldt capital asset listing was a drain cleaning machine according to the invoice.

There are no procedures in place for ensuring that donated assets are properly added to the capital asset listing. Capital assets were donated by the foundation to the facilities but not added to the accounting records of the homes. The Humboldt Facility received equipment totaling \$3,911, and the Murfreesboro Facility received equipment totaling \$6,855 from the foundation during the fiscal year.

Both facilities do perform an annual count of assets. However, as previously noted, there is no correlation between the capital asset listing upon which the general ledger is based and the inventory listing. At the Murfreesboro facility, there are no procedures in place to report and investigate any differences between the current-year inventory listing and the prior-year inventory listing. At Humboldt, the Administrator is made aware of any items that cannot be located during inventory. The Administrator inquires of staff to try to determine what happened to the item. However, there is no documentation of the investigation of lost equipment.

Even using the facility inventory listing as a capital asset listing did not prove adequate. Testwork on the tags listed in the inventory revealed that the tag number on 55 of 135 items (41%) did not correspond to the inventory listing. Therefore, the inventory administered by each facility to update the inventory listing is not complete either.

In addition, it was noted that there had not been any equipment removed from the Humboldt equipment listing in the past five years and from the Murfreesboro equipment listing in the past four years. Therefore, the listings are likely to have equipment listed that is no longer at the facilities due to loss, theft, cannibalization, or other disposition. Additionally, equipment that was no longer being used was being stored outside without protection from theft or the elements. At Murfreesboro, capital assets were inside the gate where the air compressors are located and beside a shed. At Humboldt, capital assets were also located beside a shed. None of these items

were secured in such a way as to prevent loss due to weather conditions, fire, theft, or misplacement.

Although no items were removed from the capital asset listing, several items were surplus through the Tennessee Department of General Services. As approximately 400 items were surplus, including 3 big screen televisions at Murfreesboro and a gas range at Humboldt, it appears that many of these items would have been on the capital asset listing and should have been removed from the listing when it was determined that the items were obsolete or after surplus.

When the items were surplus, proper surplus procedures were not followed. Property was removed from both facilities without the Administrator's written authorization. The board's policy states, "No item can be disposed of in any manner without the Administrator's written authorization." When property was surplus from Murfreesboro in January 2002, the only approval noted was that of the property officer. When property was surplus from Humboldt in January and March 2002, the Administrator did not approve it until April 2, 2002, a time after the property had already been removed from the facility.

The written procedures for capital assets are not adequate. The procedures do not address which assets to capitalize, the process to incorporate additions and deletions into the accounting records, the classification of capital assets, or the method for valuing capital assets. In order to establish consistency and comparability between years, the policies need to be comprehensive.

Furthermore, the board has no policies for determining the useful life of an asset. According to NHC personnel, the method for determining the useful life of an asset is to review the 1996 edition of the *AHA* (American Hospital Association) *Useful Lives Guide*. If no comparable item is found, NHC staff must rely on their own judgment. The board was unable to provide a copy of that particular guide, but based on a review of the 1998 edition of the *AHA Useful Lives Guide*, 4 of 32 items tested (13%) did not have a reasonable useful life.

Finally, it appears that the facilities may not have adequate insurance coverage. The board is insured through the Division of Risk Management within the Tennessee Department of the Treasury. According to Treasury personnel, it is the responsibility of the board to notify the Department of the Treasury when the values of the buildings and contents changes. According to a letter sent to the board from the Department of the Treasury, it is recommended that state agencies check the website of the Division of Risk Management twice a year and notify the division of any changes. Personnel at Murfreesboro were unable to tell auditors what amount of coverage the board had with the Division of Risk Management. Personnel at Humboldt stated that the facility relies on the management company for that information and the amount of insurance coverage should coincide with the capital asset listing. However, after a comparison of the capital asset listing and the insurance schedule, the amounts on the capital asset listing do not agree to the insurance schedule. The combined historical cost of the buildings and related improvements for the facilities is \$11,064,204, while the insurance coverage for buildings is only \$10,494,200. The combined historical cost of the furniture and equipment is \$1,754,942, while the insurance coverage for the contents of the buildings is only \$1,575,600. Therefore, this does not appear to be the case. In addition, based on the problems listed above, it is highly unlikely that the capital asset

listing is a true representation of the cost of the assets of the board. Also, the amount reported for insurance purposes should be replacement cost, not historical cost.

Without reconciling the annual physical inventories to the capital asset records, the misstatement of capital assets because of loss or theft could go unnoticed. If the description is the only identifying item that is included in the records, specific equipment items cannot be easily located or verified through the inventory. Identification is also difficult if the property tag number is not affixed to the asset and if the tag number does not match the inventory listing. When known losses and additions or donations are not reported to management, necessary adjustments to the furniture and equipment account and the related depreciation are not recorded. Without clear capitalization and useful life policies, there will not be consistency between similar items and between the facilities. Failure to follow established surplus procedures could result in inaccuracies in the accounting records or could result in the premature removal of useful property from the facility. Failure to adjust the level of insurance coverage could result in an unrecoverable financial loss.

Recommendation

The Executive Director should immediately attempt to resolve this material weakness. The board should work with the Executive Director to develop a specific plan of action with a specific time frame for completion and oversee the progress made. The plan should include a thorough reconciliation between the physical inventory and the management company's accounting records for capital assets. The number used in the accounting records to identify equipment items should be replaced with the property tag number. Property tags should be placed, and replaced as necessary, on equipment items. Where the actual attachment of property tags is not practical, the property tag number should otherwise be inscribed on the equipment items.

The property officer should forward the information necessary to record all additions and deletions of equipment in the accounting records to the management company. Acceptance of donated property items should require official notification to the property officer, who would then be responsible for providing the necessary information to the management company for addition to the accounting records.

Items that are no longer useful should be surplus, and when awaiting the surplus process, should be stored in a location safe from natural elements. The Administrators should ensure compliance with surplus procedures.

The board should review and clarify the capitalization policy as necessary to establish consistent procedures for capitalization and valuation of property additions. Also, the board should establish procedures and apply them consistently concerning the useful life of an asset. The board should ensure that the Executive Director analyzes and updates the current insurance coverage. The board should also create a policy to update the insurance coverage periodically and see to it that such updates are actually performed.

Management's Comment

We concur. We have failed to complete this action. A physical inventory of assets has been performed. The "reconciliation" will be accomplished by the property tag numbers being entered on to the Management Company's accounting records for fixed assets. In the future, the Property Officer will provide a copy of the Purchase Order and Bill of Sale to the management company so the item can be included in the fixed asset inventory. The Property Officer will inform management, in writing, when fixed assets have been lost, destroyed or salvaged through the State. Donated property will be recorded in the same manner. When the donor has not identified a value, the Property Officer will assign an established value.

The Board will review the capitalization policy to clarify procedures for capitalization and valuation of property additions.

The Administrators will see that unused and unneeded equipment is properly disposed of every 90 days.

Insurance coverage is being reviewed annually. The last update was October 14, 2003.

4. The board still did not comply with legally binding documents, losing control of cash flow

Finding

As noted in the prior audit, the Tennessee State Veterans' Homes Board failed to comply with Official Statements and Non-Arbitrage/Arbitrage Certificates. Several provisions within these bond documents were not followed, and as a result, the facilities lost control of cash flow. The board's unaudited annual report showed actual expenses exceeding budgeted expenses by \$218,000. Also, the timing of transactions was not in accordance with the Official Statements. Noncompliance with the resolutions is defined in the Official Statements as an event of default if the noncompliance continues after 30 days' notice from a certain percentage of bond holders. Even though the board had not complied with certain resolutions, there was not technical default, because bondholders had not taken action to seek a default. If an event of default had occurred, the board would have been exposed to certain remedies including acceleration of the due and payable date of the bond principal or the appointment of a receiver to administer the facilities on behalf of the board. Subsequent to the statement of net assets date, the revenue bonds were refunded by general obligation bonds of the State of Tennessee. The bond resolutions will no longer be in effect, but the state will require the board to perform certain transfers similar to the provisions in the former official statements. If the board continues to disregard the debt resolutions, and if the board eventually defaults on loan payments, the debt would then be a responsibility of the state's taxpayers.

The board has not accepted the responsibility for compliance with the bond documents. No one from the Tennessee State Veterans' Home Board is ensuring that the bond resolutions are

followed. The Executive Director is again relying on the trustee to ensure compliance. In response to the prior audit, the board concurred and stated that the new trustee would be monitored by the management company and that the arbitrage would be coordinated through the State Division of Bond Finance. However, due to inaction by the board, neither of these events are occurring.

In accordance with the Official Statements for Murfreesboro and Humboldt, the money deposited into the Operation and Maintenance Funds account (OMF) each month should be in an amount equal to the amount budgeted by the board. In no event shall the amount disbursed by the trustee to the OMF exceed the amount budgeted plus permitted variances. However, the facilities deposited money into the OMF in excess of the amount budgeted or permitted by the board. Expenses were incurred and paid regardless of whether they exceeded the budget. Approval was not obtained for variances from the budgeted amount.

In addition, per the Official Statement and the Arbitrage Certificate for the Humboldt facility, deposits to the OMF shall be made on or before the 25th day of each month to pay current expenses. Per the Official Statement and Non-Arbitrage Certificate for the Murfreesboro facility, deposits to the OMF shall be made on or before the first day of each month, for the payment of current expenses. Instead of transferring the projected/budgeted amount of current expenses into the OMF from the Revenue Fund during the specified period of time for the facilities, several transfers were made throughout each month to cover the expenses. This is another reason why the facilities lost control over how much was actually being spent. Only one transfer at the beginning of each month or on or before the 25th day of the month should have been made for the Murfreesboro and Humboldt facilities, respectively, and only the budgeted amount for expenses should have been transferred from the Revenue Fund into the OMF.

Also, deposits to the Bond Fund were not made in compliance with the Official Statements. For the Humboldt facility, deposits should be made from the Revenue Fund on the 25th day of each month as long as any bonds remain outstanding. The deposit amount should be equal to one-sixth of the interest coming due on the outstanding bonds on the next succeeding interest payment date and one-twelfth of the principal coming due on all such bonds on the next succeeding principal payment date. Several months passed in which the required monthly payment into the Bond Fund was not made. The required funds eventually were placed into the fund but not in the manner specified in the bond resolution.

For the Murfreesboro facility, deposits to the Bond Fund should be made on or before the first day of each February, May, August, and November from funds withdrawn from the revenue fund. The deposit should be equal to one-half of the interest coming due on the outstanding bonds on the next succeeding interest payment date and one-fourth of the principal coming due on such bonds on the next succeeding principal payment date. The required funds eventually were placed into the fund but not in the manner specified in the bond resolution.

The Official Statement states that deposits to the Repair and Replacement Fund for Humboldt are to be made in an amount of no less than \$17,850 on the 25th day of each January and July. It was found that instead of making a single payment on July 25, 2001, several smaller

payments were made during the year. However, these payments did not reach the required \$17,850 amount. The deposit in January 2002 was made in compliance with the Official Statement.

According to the Official Statement for Murfreesboro, if monies are withdrawn from the Repair and Replacement Fund, they are to be deposited back into the account from the Revenue Fund each succeeding February, May, August, and November for a time of 24 months. In May 2002, funds were removed from this fund in order to purchase an HVAC system. The board agreed to transfer equal monthly installments back to the Repair and Replacement Fund over a period of 24 months. However, after reviewing the general ledger for the months after the end of the fiscal year under audit, it appears that these installments did not occur. The fund received interest monthly and one large transfer to replenish the fund in December 2002. This activity is not in compliance with either the Official Statement or the board-approved process for replacing these funds.

Per the Official Statement, earnings for the Bond Fund in Humboldt should be considered revenues and placed in the revenue fund. However, for June 2002, earnings were retained in the Bond Fund. Also, interest earnings on the Repair and Replacement Fund were not deposited into the Revenue Fund during June 2002, as required by the Official Statement.

Per the Official Statement for Humboldt, a Subordinate Payment Fund should have been established to pay the management fees. Although the fund was established, it has not been used.

In addition to the above occurrences of noncompliance, the facilities were not in compliance with IRS arbitrage requirements. The IRS regulations generally do not allow issuers of tax-exempt bonds to invest the bond proceeds so that they produce a higher yield. This is referred to as arbitrage. Annual arbitrage calculations are generally necessary to determine whether there is a liability to the federal government for interest earned on higher yields. The Arbitrage and Non-Arbitrage Certificates state that the board will ensure that the bonds will not be subject to arbitrage. A responsible employee should perform an annual review to determine whether or not an arbitrage calculation was needed. If an arbitrage liability was to be paid, it should have been paid in a timely manner and according to the specifications established by the IRS. No one performed an annual review to determine if any arbitrage should have been paid or accrued.

Recommendation

The board should review the new loan requirements related to the refunded bonds. The Executive Director and the board are ultimately responsible for compliance with all requirements. The Executive Director should designate an employee to examine all the requirements and ensure compliance. The responsibility for this function should not be solely entrusted to the trustee. The Executive Director should ensure that the trustee makes the appropriate transfers.

The Executive Director should also ensure that a responsible employee performs an annual review to determine whether the bonds issued created an arbitrage situation. Timely payment should be made for any calculated arbitrage liability.

Management's Comment

We concur that arbitrage calculations were not performed during the audit period. Arbitrage was performed in September 2003 and an arbitrage liability was paid.

We concur that several provisions within these bond documents were not followed; however we do not concur that the facilities lost control of cash flow. While it is true that the bond trustee did not transfer monies as dictated by the bond documents, for the most part these failures were discovered by the Board and corrected during the second half of the audit period. It is a real stretch to assert that at any time the Board was in danger of defaulting on loan payments. For the audit period in question, Chase Manhattan was the Trustee from the period of June 1, 2001 through October of 2001. Because of numerous problems similar to the ones identified by the auditors, that trustee was replaced by U.S. Bank. U.S. Bank assumed management of the trust November 6, 2001. In May of 2002, in response to a cash flow problem discovered by the Board and representative of State Bond Finance Division, the Board put together the Income over Expense (aka Receipts and Disbursements) spreadsheet for the then current fiscal year, July 1, 2001 through June 30, 2002. In order to compare to the financials, the Board then reconstructed fiscal 7/00 through 6/01 to the best of our ability. The Board has kept this spreadsheet up to date ever since. The Board then put together the Cash and Equivalents spreadsheets from the U.S. Bank Statements and a few Chase Manhattan statements going back to July 1, 2001. The Board tried to reconstruct the previous fiscal year from the Chase statements, but was unable to complete this because of a number of missing statements. The Board began tracking expenses on the Operating and Maintenance Account spreadsheets as of July 1, 2002, the first "budget year" with both NHC and U.S. Bank. U.S. Bank had indicated that they were going to follow the bond documents exactly; therefore, we felt it prudent to convert that budget to a "cash flow" budget for transfers. July 2002 – June 2003 was the first fiscal year that the Board tracked expenses this way.

The TSVHB bonds have been redeemed through the sale of state GO bonds. The bond documents have been replaced with funds management guidelines prepared by the Funding Board. The funds management guidelines will now be the legally binding contracts.

Auditor's Comment

As stated in the finding, noncompliance with the resolutions is defined in the Official Statements as an event of default if the noncompliance continues after 30 days' notice from a certain percentage of bond holders. We did assert that noncompliance with several provisions did occur. We did not assert that the board was in danger of defaulting on loan payments. Due to the bond refunding and the disclaimer of opinion on the financial statements, we found it

necessary to point out that if default were to occur in the future, the debt would then be a responsibility of the state's taxpayers.

5. Management still did not monitor the activities of the trustee and did not maintain internal control over cash

Finding

As noted in the prior audit, the board did not maintain internal control over cash. As a result, numerous errors occurred in the trust accounts and in the cash accounts on the general ledger. The trustee is responsible for managing the cash and funds invested with the Local Government Investment Pool (LGIP) and the United States Department of Treasury obligations that are restricted by bond covenants. The board deposits revenues into a depository account. The trustee is responsible for transferring depository account revenues into a revenue fund account and from that revenue account into an operating and maintenance fund account, repair and replacement fund account, or a debt service fund account in accordance with the bond covenants. Money is wired out of the various accounts, after authorization from the board, to make bond principal and interest payments and to pay the operating expenses of the board. The trustee is also responsible for allocating the interest earned to the various accounts. The management company was responsible for managing the accounting records of the board. As such, the management company was responsible for reviewing trustee statements and ensuring only authorized transactions occurred and that authorized transfers were recorded correctly in the general ledger.

In response to the prior report finding, the board conceded that these problems existed during the prior fiscal year. Management also stated that, subsequent to February 2002, the management company had monitored the activities of the Bond Trustee. However, it appears that problems existed throughout the fiscal year under audit and that the management company was not monitoring the activities of the Bond Trustee.

During the audit period, two different trustees made errors recording the activity in the accounts. Errors included failure to record a withdrawal from LGIP in its full amount, failure to record interest earned on LGIP accounts timely and in its full amount, and mistaking the withdrawal of funds from a bank investment pool for the withdrawal of funds from LGIP. Errors also included recording what appear to be two transfers of LGIP funds to bank accounts as new deposits from the depository account. This error resulted in a cash overstatement of \$97,523. During November 2001, the trustee sent a Murfreesboro deposit to the Humboldt account and one Humboldt deposit to the Murfreesboro account. That error was not discovered until January 2002.

The management company did not monitor the trustee transactions. In addition, the LGIP statements were not reviewed by anyone other than the trustee. Several entries were made during the first part of the fiscal year in the general ledger to increase or decrease the restricted cash recorded to equal the trustee statements. Since the trustee statements during this time were not

reliable, these entries were unsupported and unauthorized. Several more errors were made by the trustee, and several general ledger entries cannot be supported. A total of \$125,375 of unsupported management company entries occurred that decreased cash recorded on the ledger. A total of \$294,280 of unsupported management company entries occurred that increased cash recorded on the ledger. The board was made aware of these entries in the prior audit report and was informed that the ending cash on the general ledger on February 28, 2002, was \$118,676 higher than the amount of cash actually in LGIP or included in trust accounts. The recommendation made to the board at that time was that these entries, the trustee statements, and the general ledger should be reviewed and these issues should be resolved. However, the unsupported entries were not reviewed or resolved, and the financial statements were not adjusted appropriately. The management company instead left everything the way it was except it set up a new and separate general ledger account entitled "Reserve Accounts – Other," where it moved the \$118,676 balance of cash that did not exist. As a result of this failure to properly investigate these matters, assets recorded in the facilities' general ledger were overstated by this amount. In addition, the entries made to balance to the erroneous trustee statements may have caused the board to suffer a loss of cash during the first part of the fiscal year since cash could have been removed from one of the accounts and the books would have been adjusted without investigation.

The board did adopt policies regarding the transfer of funds. According to the Transferring Funds Policy, the board representative is to forward a signed Transfer of Funds form to the management company when funds are to be transferred. The trustee is to forward a confirmation to the board representative when the funds are transferred. However, it was noted that these forms were not completed for the debt service transfers at the Humboldt facility. Likewise, no confirmation was obtained from the trustee, noting that transfers had been completed.

Currently, the management company uses the trustee statements as support for recording transactions to the general ledger. Transactions are being recorded based on these statements entirely, and no comparison to authorized transactions is being documented. Also, there is no reconciliation or documented review by the board. In addition, according to board personnel, the trustee reviews the LGIP statements. However, there is no documentation of this, and the board does not review the LGIP statements. This situation is an invitation for unauthorized transactions and for the sort of lax recordkeeping performed by the prior trustee and the prior management company. If not rectified, these conditions could result in more unsupported transactions and another misstatement or loss of cash.

Recommendation

The board should immediately address the control issues noted in this repeated finding. The board should determine why action has not been taken to resolve this issue. The board should also determine why the approved policy is not being followed. As was recommended in the prior audit, the board should review the trustee statements and the general ledger for July 1, 2001, through the present and resolve the transactions that were recorded incorrectly. The board

should be actively attempting to recoup funds that it has determined that the prior trustee or the prior management company owes the board for unresolved errors. Also, the board should determine what, if any, recourse it might have for breach of contract related to the current management company. The Executive Director should ensure someone independent of the trustee obtains LGIP statements for monthly reconciliation to the trustee statements and to the general ledger. Entries should be made to the restricted accounts based on authorized transactions only. In addition, the Executive Director should ensure that the trustee statements are reviewed by someone independent of those responsible for recording or authorizing trustee transactions. These reviews should be examined and approved by the Executive Director. The trustee statements should only be used as support for the recording of transfers within the funds and the recording of interest earned. Since cash is such a sensitive account, the board should consider periodic review of the cash accounts, and the Executive Director should approve the trustee and LGIP reconciliations performed.

Management's Comment

We concur that this finding existed in the first half of the audit period. However from February forward, the management company has monitored the activities of the Trustee, has noted errors and directed posting corrections.

The management company was BEP until the end of December, 2001. From January 1, 2002 through December 31, 2002 the management company was NHC. Beginning January 1, 2003, NHC began providing business office support and health care management consulting. The Trustee for the period June, 2001 through October, 2001 was Chase Manhattan Bank. The Trustee for the period November, 2001 through the end of the audit period was U.S. Bank. Because of the problems noted by NHC and the Board, these banks are no longer the Board's Trustee. LGIP statements were reviewed by the management company and it was from these statements that interest was recorded on the management prepared financials. However the movement of funds between bond accounts could not be monitored on the LGIP statements because the statements recorded LGIP funds as one lump sum. As there were no supporting documentation for the BEP transactions increasing and decreasing cash that resulted in the general ledger showing \$118,676 more than actually in the LGIP or trust accounts, the Board requested and NHC adjusted the June 30, 2003 financial statements to eliminated the "Reserve Accounts – Other" containing \$118,676.

We concur that one instance existed where the transfer form was not used at Humboldt to make the transfer to the debt service fund. However it was understood by Humboldt that this transfer, along with the transfer to the Repair and Replacement fund would be made automatically each month as it was a consistent amount each month. These transfers did take place with some exceptions that were identified by Humboldt and subsequently corrected.

We do not concur that the management company solely uses the trustee statements to record transactions to the general ledger. The management company uses cash receipt postings, cash disbursement postings, bank statements and bank reconciliations to record transactions to

the general ledger. The management company also utilizes reoccurring entries for routine entries that are checked monthly to insure these transactions are occurring.

Auditor's Comment

It is true that the majority of the issues mentioned in the finding occurred in the first part of the audit period. However, the effects of those issues and the underlying controls that allowed such problems to occur have still not been resolved.

We continue to contend that the management company does rely on the trustee statements to record certain transactions to the general ledger. The board mentioned that the management company uses certain postings and bank information to record the transactions. However, these documents can only be used to support some of the transactions related to trustee accounts. Without obtaining LGIP statements, there are not "bank statements" or "bank reconciliations" to consult related to many of the trustee transactions. The board did not respond to the recommendation that someone independent of the trustee should obtain LGIP statements for monthly reconciliation to the trustee statements and to the general ledger or to the recommendation that the Executive Director should approve such reconciliations. This is an essential control to ensure that the trustee statements and any accounting entries related to the trustee statements are accurate.

6. Management failed to provide adequate documentation for the audit process

Finding

Management did not retain all documentation necessary for the audit process, resulting in a disclaimer of opinion on the financial statements. Also, management was extremely lax in the simple organizational skills for effective office management. Even after discussions with personnel at both facilities emphasizing the importance of the documentation, little assistance was provided. As a result, the audit process took much longer than expected, and it was determined that much of the documentation was missing.

During the prior-year audit, as the former management company was winding down its operations, it was to send any documentation dealing with the board to the facilities. The prior-year auditors were able to manually sift through those boxes provided to find audit documentation. During the current-year audit, the board's financial documentation was again provided to the auditors in boxes. Upon arrival to the Murfreesboro facility, the auditors were given over 40 boxes. These boxes were labeled as to their contents. However, a temporary employee was the person who labeled the boxes. As a temporary employee, she did not know the purpose of reports or other documentation. This is not an effective filing system for a veterans' home. When documentation could not be found by the auditors after looking in all logical places based on the boxes' labels, management would be given a list of items needed by the auditors. Management could not, or in some cases, would not, find the requested documents either.

In addition, it was noted that the information generated by the information system did not always correspond to the actual documentation after it was found. For instance, if a vendor changed ownership, but not location, the name might not be changed in the information system. Therefore, such invoices could not be located since they were under a different vendor name. There were also inconsistencies noted in the filing system. Payments made to the Tennessee Consolidated Retirement System might be filed under "Tennessee," "Retirement," "TCRS," or "Treasury."

During the planning of the audit, the auditors requested and received a listing of all employees whose employment had been terminated or who had been placed on administrative leave or suspended. At the Murfreesboro facility, after the list was received, many of the personnel files requested could not be located. Out of 121 employee files requested, 22 (18%) could not be provided to the auditors. Even though six boxes labeled "Terminated employee files" were provided to the auditors, gaps and overlaps were noted in the boxes. Of the 22 missing files, 18 were for employees with last names that began with a "G," an "H," or an "I," indicating that one entire box was missing. Management stated that the box may be out in a shed but did not make an effort to locate it.

In addition, the Murfreesboro facility could not provide any deposit slips for the Room and board account for the entire month of August 2001. This facility also did not retain the copy of the deposit slips from the employees making the deposit for the months of July through December 2001. The facility was able to provide the pink carbon copy (the copy that was returned by the bank) for July and for September through December; however, the carbon copy did not have the documentation showing which cash receipts were included in each deposit.

Several other invoices or other supporting documentation were requested during various phases of testwork. However, the documentation could not be provided. During a sample of disbursements from both facilities, supporting documentation for ten out of 59 (17%) items could not be provided to the auditors. The missing documentation caused expense transactions to be unauditable.

At the Murfreesboro facility, we could not locate supporting documentation for 21 invoices from selected vendors totaling \$39,376 and supporting documentation for 2 checks written in July 2002 totaling \$117. The facility also could not provide 2 of 32 checks written between June 25 and July 5, 2002, totaling \$116,806, including the supporting documentation related to one of the checks for \$27,193.

As noted in finding 10, seven items included in the general ledger as possible travel expenses for Humboldt were requested but could not be provided to the auditors. Several other invoices or other supporting documentation were requested during various phases of testwork at Humboldt. However, the documentation was not provided. These items included supporting documentation for an account payable at June 30, 2002, of \$436, and certain required support for two checks written in July 2002, totaling \$592.

At the Humboldt facility, six months of reports from the previous management company's system could not be provided to the auditors. The reports missing included cash receipt reports, payment and charges recaps, and room and board charge registers. These reports did exist while auditors were in the field following the conclusion of the prior-year audit. In addition, a Medicare Rate Report for the month of November 2001 could not be provided to the auditors.

According to Section 8-4-109, *Tennessee Code Annotated*, the Comptroller of the Treasury "shall have the full cooperation of officials of the governmental entity" during the audit process. During the audit of the fiscal year ending June 30, 2002, the Comptroller's Office did not have the full cooperation of management. As a result of the lack of documentation, numerous hours were spent looking for documentation and trying to find alternate methods of testing. Management must take responsibility to ensure that information is relevant and available to auditors in a timely manner. Also, business office personnel require some of this documentation from time to time to research transactions. Without an effective filing system, personnel are not able to complete their tasks efficiently. Furthermore, without documentation, the auditors are unable to obtain reasonable assurance that the financial statements are fairly presented.

Recommendation

The board must take the responsibility to ensure all information related to the fiscal year under audit is available to auditors. The Executive Director should immediately adopt an effective file management system that allows business office personnel to locate documents as requested. A document retention policy should be instituted that meets audit needs and the needs of the board. The board should stress the importance of this to management and take administrative action as necessary if changes are not made. As the new management company transitions out and as information systems change, the board must take the initiative to produce paper copies of information that may not be available at a later date. Ultimately, the board is accountable for everything that happens within the facility and must ensure adequate documentation is available.

Management's Comment

We concur. During the last audit, this was an issue. The records lost by BEP were discussed at length with the audit team as a problem for that audit and for future audits. BEP, as part of their management duties, maintained most of the records that could not be provided. BEP declared bankruptcy and transferred boxes of documents to the facilities they managed. We received numerous shipments of documents as they were discovered by BEP and we also exchanged, with other facilities managed by BEP, records that were mistakenly shipped to our facility and records that were mistakenly shipped to a separate facility. The staff at both facilities made a concerted effort to locate and organize those records. The failure of staff to find and organize records to the satisfaction of the auditors was equally a factor of missing records and the

time required to find and organize. Additional staff was hired, but as pointed out by the auditors, the additional staff often did not fully understand the reports. The use of permanent staff was limited by the need to keep current business office functions working.

We do not concur that the facility staff was uncooperative. The absence of records and the poor organization of other records was a frustration to Board staff as well as the auditors. This frustration as well as a need to complete daily activities to operate the home may have been construed as a lack of cooperation. At no time was a lack of cooperation by the staff members brought to the attention of the Board, the Executive Director, or the Administrators. Board staff exhibited frustration, but not a lack of cooperation. The Board recognizes that there is insufficient on site storage for all of the records required. The Board will determine the storage needs and establish adequate storage facilities.

The Board, in October of 2003, sent two business office personnel, one for each existing home, to the records management class conducted by the state. These staff members, along with the administration, will develop the policies and procedures to properly maintain the records of the Board. The Board will hire additional personnel to organize existing records according to those policies. The Board received from the Division of Accounts, Finance and Administration a listing of paper copy information that needs to be produced from the current management company's system. These records will be prepared and kept for future audits.

Auditor's Comment

As mentioned in management's response, the need for staff to complete daily activities and the staff frustration due to the poor organization of the records were factors. These factors led to a lack of effort which was indeed construed as a lack of cooperation.

7. Internal controls for information systems are not adequate

Finding

On January 1, 2002, National HealthCare Corporation (NHC) started serving as the management company for the Tennessee State Veterans' Homes Board. As the management company, NHC was responsible for establishing and maintaining the information system used in the facilities. Significant deficiencies exist in the internal control related to this information system.

The information system used in the facilities is based on a UNIX operating system and was developed by NHC. It includes applications for accounts receivable, accounts payable, resident care, equipment, payroll, and the general ledger. These applications contain confidential resident information that should only be viewed by those personnel whose job responsibilities require them to access this information.

In general, very few policies and procedures, either written or unwritten, relating to the information system are maintained.

- There is no written policy in place regarding passwords for the system. In addition, there are no procedures to change passwords on a periodic basis. Thus, passwords are not changed.
- A formal disaster recovery plan has not been developed and approved. Also, no alternate processing site has been established.
- There is no formal steering or planning committee established to oversee major Information Systems (IS) functions.
- There is no written policy regarding program changes. No documentation is maintained that indicates management approval and assignment of program change requests to individual programmers. No documentation is maintained to indicate the results of tests performed when programs are changed, nor does management review changed programs before they are moved into production. In addition, no documentation is maintained for changes made to the system software.
- Controls over table file settings are inadequate. Table file changes are not reviewed by NHC management. Table file settings are not inspected and reviewed periodically.
- There are no procedures to monitor use of the system. According to information systems personnel at NHC, the system itself can generate an e-mail message to the programmer when errors occur or when unauthorized usage is detected. However, personnel could not provide examples of circumstances that would warrant an e-mail being generated. Also, no listing of errors is maintained. Therefore, it would not be possible to monitor correction of these errors and determine the cumulative effect of these errors.
- No organization chart for the IS department is maintained.
- Written job descriptions for the IS positions could not be provided.
- No documentation is maintained that indicates how fire procedures are communicated to new personnel.
- No user manuals or operating instructions are available for the general ledger application.

In addition to a lack of written policies or procedures related to the information system, several instances of improper access to the system were noted.

- Seventeen of 40 employees tested (43%) did not have a written request from management granting them access.
- Two of 23 employees tested (9%) had an incomplete request. The request did not indicate the type of access to be given.
- Two of 23 employees tested (9%) did not have a properly approved request. According to NHC information system personnel, their procedures require a written request

approved by the facility's Administrator. This approval is typically in the form of an email from the facility's Administrator.

- One of 23 employees tested (4%) had a higher type of access than the access requested. The request stated that this employee should have LPN access (code 182). A review of the Terminal Access by Center listing (a listing of all board personnel with access to the system as well as the level of access granted) indicated that this employee has Charge Nurse access (code 184).
- Twelve of 40 people tested (30%) were individuals who were no longer employees of the facility. These individuals' employment had been terminated between 4 days and 465 days prior to the date of the report listing individuals with access to the system.
- Screens observed on the Murfreesboro Administrator's computer were not included on the NHC Program Access by Terminal Code Listing of screens. The Program Access by Terminal Code Listing is a report that indicates the screens available to a particular level of access. For instance, if an individual has level 101 access per the Terminal Access by Center listing, the individual should have access to all screens listed on the Administrator (level 101) section of the Program Access by Terminal Code Listing.
- One screen included in the NHC Program Access by Terminal Code Listing (Administrator - Code 101) could not be accessed by the Administrator causing doubt as to the accuracy of the access capabilities listing.
- According to the Program Access Terminal Code Listing, all codes tested should allow users to access certain screens identified as PH type screens. These screens could not be observed on the Administrator's or Activities Department Head's computers at Murfreesboro. Both individuals should have had access to these screens. However, a security message appeared stating that these individuals did not have this type of access.
- Twenty-one of 135 employees with access to the system (16%) have access to a payroll screen where changes can be made to the time worked if employees work overtime or lose their clock-in badge. This percentage seems extremely high, and it appears unnecessary for 21 individuals (10 at Murfreesboro and 11 at Humboldt) to be able to make manual changes to the time clock and ultimately be able to affect payroll. After discussion with personnel at both facilities, it appears that only one employee at each facility uses this screen. Access to sensitive information like employees' payroll information should be limited to those individuals whose jobs require that level of access.
- One of 40 employees tested (3%) has access under two codes. As employees move from one position to another, their access should be updated to reflect new responsibilities. Likewise, access should be restricted to those new duties.
- A lack of segregation of duties is also indicated by the access levels granted to employees. An employee at Murfreesboro who approves accounts payable has access to a screen where payables can be initiated. The payroll officer at Humboldt during the audit period had the ability to post cash. This employee was also responsible for preparing the bank reconciliation. The assistant bookkeeper at Humboldt is able to post cash. This individual is also responsible for preparing the deposit.

It was also noted that controls over table file settings are inadequate. Table files control reference information for system processing, such as terminal codes and procedure codes. Table file changes are not reviewed by NHC management. Also, table file settings are not inspected and reviewed periodically. Changes to critical table information could occur and go undetected.

Effective internal control would include written policies and procedures as well as maintenance of adequate documentation. Inadequate controls over access could result in sensitive information being obtained by inappropriate parties. With the heightened federal standards regarding sensitive information, especially those of the Health Information Portability and Accountability Act (HIPAA), including substantial fines for violations, it is increasingly important to guard this information from inappropriate parties.

Recommendation

Whether the information system is maintained by the board or by a management company, adequate documentation should be maintained for the tasks performed by the IS department. Written policies and procedures should be developed and should adequately address system issues. Regardless of whether board personnel or consultants develop such policies, the board is ultimately responsible for internal control. The security and controls over the system should become a priority for the board. To ensure adequate segregation of duties, the Administrators should limit access to those individuals whose jobs require access to different areas of the system. When employment is terminated, the Administrators should ensure that access to the system is removed immediately. Documentation requesting access should be maintained by business office personnel. A steering or planning committee of the board should be in place to oversee IS functions. A disaster recovery plan as well as an alternate processing site should be established in the event of an emergency. Table file settings should be periodically inspected, and changes should be properly reviewed.

Management's Comment

The information system referenced is owned by NHC. With the purchase of an information management system for the Board, the recommendations of the auditors will be used as a guide for development of controls.

8. Collection efforts for accounts receivable are not adequate

Finding

Collection efforts for accounts receivable at the facilities are not adequate. The board does have written procedures in place to collect receivables, but the procedures are not followed and actions are not documented. If receivables will never be collected, these accounts should be written off. However, write-offs cannot be approved until adequate collection efforts have been

performed. At June 30, 2002, resident accounts receivable from private payor sources was \$1,925,482. Of this amount, \$1,404,018 was over 180 past due.

The Murfreesboro facility's procedures include completing forms when telephone calls are made, sending letters to responsible parties, and turning in names to the Administrator for additional telephone calls. The Humboldt facility procedures include completing forms when telephone calls are made and turning in names to the Administrator for additional telephone calls. The board has also contracted with a collection agency to further attempt to collect on accounts receivable before write-off.

In order to test the board's collection efforts, individuals with receivable balances over \$10,000 at June 30, 2002, were selected. A current aging report was then reviewed. If the receivable balances for the individuals had decreased significantly subsequent to the June 30 date, no further testwork was performed. If the balances had not decreased significantly, the documented efforts to collect the receivables were reviewed.

For the Murfreesboro facility, the efforts to collect from 20 of the residents were reviewed. The total of these balances at March 4, 2003, for services received prior to June 30, 2002, was \$374,417. Results from this testwork revealed that adequate documentation of collection efforts did not exist in 6 of the 20 residents' balances (30%). In addition, 4 of the 20 residents' balances (20%) did have documented collection efforts and should have been turned over to the collection agency.

For the Humboldt facility, the efforts to collect from 18 of the residents were reviewed. The total of these balances at May 28, 2003, for services received prior to June 30, 2002, was \$330,894. Results from this testwork revealed that adequate documentation of collection efforts did not exist in 10 of the 18 residents' balances (56%). In addition, the remaining 8 of the 18 residents' balances (44%) should have been turned over to the collection agency. When a listing of those accounts turned over to the collection agency was requested, Humboldt business office personnel were not even aware that accounts could be sent to a collection agency.

If personnel do not document what attempts are being made to collect accounts receivable, unpursued accounts could go unnoticed. Without proper collection efforts, money owed to the board goes uncollected. As receivables will remain on the general ledger until adequate collection efforts have been made and documented, accounts receivable and the related allowance for doubtful accounts may be overstated.

Recommendation

The board should ensure that collection policies and procedures are adequate and that they are being communicated to and followed by business office personnel. The Executive Director should ensure that collection attempts are made in a timely manner and that the attempts are documented fully. After the required attempts by board personnel have failed, the Executive Director should immediately submit the accounts to the collection agency. After collection

agency efforts are exhausted, the Executive Director should take the necessary steps to write off the uncollectible accounts.

Management's Comment

We concur. Policies and procedures will be reviewed for adequacy. Due to a turnover of business office personnel at both facilities, collection procedures were not adequate at Murfreesboro until November 2003 and at Humboldt until December 2003 when the problems with accounts receivable were noted and the business office began to follow collection procedures.

9. The foundation board continues to improperly use Veterans' Homes Board employees and resources for its operations

Finding

As noted in the prior two audits, the foundation affairs are not independent from the board, its personnel, or facilities. Currently, foundation operations are performed primarily at the Murfreesboro facility by Veterans' Homes Board personnel. Board employees handle the cash receipting and financial records for the foundation.

Attorney General Opinion No. U94 – 037, dated March 10, 1994, indicates that the foundation

must operate independently of the Board and its personnel and facilities. . . . State resources such as state personnel and state facilities should not be devoted to the operation of such a [foundation]. . . . The affairs of the Board must remain separate and distinct in all respects from the affairs of the [foundation].

The opinion recognized that private citizens may establish and operate nonprofit corporations for fundraising; however, the board is not authorized by law to create or operate such a corporation. The foundation board has knowledge of this opinion but chooses to use Veterans' Homes Board resources rather than expending funds derived from donations for the administrative expenses of the foundation. The foundation board includes 11 members, 6 of which are appointed by the Veterans' Homes Board. In the prior two audits, the board and the foundation board did not concur with this finding and stated that complying with this finding would not be cost effective. However, the board does not have the authority to disregard this opinion merely due to financial considerations.

Recommendation

In accordance with the Attorney General Opinion, the board should take action to ensure that the operations of the foundation are separate from the operations of the board, its personnel, and facilities.

Management's Comment

We do not concur. The expense of paying additional personnel from donated funds to carry out administrative duties cannot be justified. The activities of the Executive Director and the Executive Assistant at Murfreesboro in support of the Foundation are insignificant to their normal duty requirements. Employing additional personnel to perform that duty would take resources away from the veterans the Foundation was set up to support.

Auditor's Comment

The board again is using cost-effectiveness as justification for continuing to utilize board employees for the duties of the private foundation. As addressed in the finding, the board does not have the authority to disregard an Attorney General Opinion merely due to financial considerations.

10. Travel claims again were not in compliance with Comprehensive Travel Regulations, resulting in excessive reimbursement of over \$2,000

Finding

As noted in the prior-year audit, travel claims were not in compliance with the Comprehensive Travel Regulations. Regarding travel by board members, Section 58-7-105, *Tennessee Code Annotated*, states,

All reimbursement for travel expenses shall be in accordance with the policies and guidelines approved by the board, but shall not exceed the maximum reimbursement for travel expenses allowed by the provisions of the comprehensive travel regulations as promulgated by the department of finance and administration and approved by the attorney general.

The management of the veterans' homes have chosen to adopt the same regulations for all travel by employees of the homes.

Management concurred with the prior-year finding and stated that in-service training would be provided for staff on travel claims in order to eliminate this problem. However, the in-

service training was not conducted until near the end of fiscal year 2002. Therefore, most of the problems still existed as of June 30, 2002.

All travel claims as well as additional items that were charged to travel expense accounts were selected for review. Seven items were not available to the auditors and were noted as missing by board personnel at the Humboldt facility. Of these seven items, six appeared to be related to travel while one appeared to be tuition reimbursement. Most of the travel claims submitted by the staff or board members of the Tennessee State Veterans' Home were incorrect in some aspect. In Murfreesboro, 100 of 103 travel claims (97%) and in Humboldt, 109 of 110 travel claims (99%) were not completed in accordance with state policies. Travel claims were not always signed, dated, or approved. Other problems noted with the travel claims included untimely submission; incorrect mileage, hotel, and per diem reimbursements; and improper usage of travel claims for expenses unrelated to travel.

The appropriate signatures and approvals for travel claims were not always obtained. Numerous travel claims were not approved by the designated individuals. Per the Veterans Home travel policy, "The fiscal agent or his designee will complete and submit all travel reimbursement to the chairman of the board for signature. The fiscal agent or his designee will then forward the travel reimbursement forms to the management company for reimbursement." In Murfreesboro, 91 of 103 claims (88%) and in Humboldt, 99 of 110 claims (90%) were not properly approved for payment. A folder was provided that showed chairman of the board approval on some of the claims included in the above number. However, these approvals were not obtained before disbursement of the funds and therefore were not in accordance with policy. There were also instances of the Humboldt assistant to the Executive Director signing the Chairman's name; the Murfreesboro assistant to the Executive Director preparing, reviewing, correcting, and approving claims for disbursement; and at least one instance of the claim being approved before being completely filled out.

According to Section 10 of the regulations, employees should submit travel claims for reimbursement of travel expenses no later than 30 days after completion of travel. In Murfreesboro, 13 out of 103 claims tested (13%) were submitted untimely. In Humboldt, 6 of 108 travel claims (6%) were not submitted within 30 days after travel was completed. The time between the covered period and submission of claims ranged from just over one month to 12 months later. In addition, in Murfreesboro, 47 of 103 travel claims tested (46%) were not dated and in two cases (2%) were not signed by the claimant. In Humboldt, 48 of 110 (44%) were not dated by the claimant.

According to the travel regulations, reimbursement for miles when using personally owned vehicles is at the standard mileage rate of \$.32. Also, mileage should equal the mileage from the official state map with reasonable vicinity miles. Ten of 88 travel claims tested (11%) for Murfreesboro had mileage that appeared excessive. Also, one claim was reimbursed at the wrong rate. Excessive mileage was also present in 25 of 97 travel claims (26%) from Humboldt, and 6 had miles reimbursed at the wrong rate. Another mileage-related problem noted was the fact that there were several claims that included mileage from the claimants' residence to their official station. According to one of the individuals receiving these funds, the board reimburses

for travel expenses if an employee is asked to work on a normal day off for that individual even though this is not normally allowable per Comprehensive Travel Regulations. Based on a review of the dates for which this mileage was claimed, it appeared that mileage was claimed on weekends or holidays. If this practice is to continue, it should be addressed in the board's travel policy.

In addition to the reimbursement rates for mileage, the travel regulations set guidelines for hotel reimbursements as well as incidental expenses (meals, telephone charges, etc.) on a per diem basis. These rates vary based on the county or city of destination. The Department of Finance and Administration also makes available a listing of hotels in the state that have agreed to charge employees on official state business only the approved rate for reimbursement. In Murfreesboro, 7 of the 46 travel claims with hotel expenses (15%) and in Humboldt, 4 of 35 travel claims with hotel expenses (11%) were not reimbursed for the correct amount. Problems included higher than allowed room rates, and unallowable phone calls and movie rentals being reimbursed. The per diem rates for incidentals were also incorrect in several instances. There were two travel claims from Murfreesboro and four travel claims from Humboldt that included unallowable reimbursements for meals unrelated to overnight travel.

Finally, the travel claims for both facilities reimbursed employees for expenses that were not related to travel. Nine travel claims were noted in Murfreesboro that contained items that were not travel-related. Humboldt's travel claims included five that contained non-travel items. These items included a battery for a laptop computer, professional dues, telephone bills, a donation to Special Olympics, and the rental of a conference room. In addition, there was one instance of an employee being reimbursed for the lunch of board members and other employees who were either on travel status (who would have received a per diem for meals and incidentals) or were at their official station (and thus not entitled to meal reimbursement). By using travel claims for items that would normally be purchased through the accounts payable system, any controls that are in place for the payables system are circumvented. The requests for philanthropic donations and professional dues may have been declined as unreasonable or unnecessary had they gone through the proper approvals. In addition, in one instance, sales tax was paid. Had this item been purchased through the payables system, this additional charge would have been avoided.

As a result of not adhering to the travel regulations, numerous travel claims were overpaid. Excluding potential overpayments related to individuals overclaiming mileage, the board appears to have made overpayments and payments for unallowable items in the amount of \$2,012.

Recommendation

The staff and board members of the veterans' homes should be knowledgeable about the state travel policies that have been adopted. The Executive Director should ensure all travel claims are completed in accordance with these policies by instructing the individuals responsible for accounts payable not to pay any travel claims that are not properly approved. The Executive

Director should continue to provide training related to submission deadlines and allowable charges to the staff, particularly the individuals responsible for approving claims.

Management's Comment

We concur. Training for Board staff was conducted at Humboldt in March of 2003. Training at Murfreesboro was conducted on December 8, 2003. Travel vouchers for Board members are prepared by Board staff with information provided by the Board members. The policy on approval of travel vouchers will be reviewed for a more practical policy of who approves travel claims. A policy on claims for non travel related expenses will be developed, Board personnel will be made knowledgeable, and administrators will insure compliance.

11. Internal control for purchasing is not adequate

Finding

As noted in the prior two audits, the Tennessee State Veteran's Homes Board facilities do not have an adequate segregation of duties related to purchasing, the board's policies and procedures over purchasing are not being followed, and service contract approvals required by state law are not being obtained.

In the prior-year audit, management agreed that the deficiencies did exist and stated that the policies and procedures had been modified to remedy these deficiencies and that contracts were in the process of review and update. However, the modified policy was not adopted by the board until August 1, 2002, and the contract review process was not completed. Therefore, during the audit period, the conditions still existed.

At both facilities, the same individuals ordered and received supplies. If one individual is responsible for both ordering and receiving goods, the opportunity for fraud is increased. Individuals could order goods and divert them for personal use or could, through collusion with a vendor, order goods which are not delivered but for which payment is made. Fictitious vendors could also be created.

Also, purchase orders were not used appropriately, and support for payment was not appropriate at the Humboldt facility. The maintenance director used the services of an independent contractor for various small projects within the facility. There was no written contract between the board and the contractor. The maintenance director prepared the invoices to the facility on behalf of the contractor as the work was completed. However, the purchase orders were prepared only after the invoices were prepared. As the purchase orders were not prepared until after the work was completed, the process of prior Administrator approval was circumvented. In addition, allowing payments from board funds based on invoices that were created by employees, rather than received from third parties, increases the risk of fraud and overpayments to third parties.

The policies and procedures in place during the fiscal year under audit require department heads to complete purchase requisitions and to submit them to the central purchasing clerk. The clerk is then to give the requisitions to the Administrator for review and approval. After approval is obtained, the clerk is to initiate a purchase order to the vendor. The procedures also require that a purchase requisition and purchase order will be completed for all purchases. Purchases over \$1,000 require the approval of the Executive Director, and purchases over \$5,000 require the approval of the board. Purchase orders less than \$500 may be initiated without bids, purchase orders between \$500 and \$1,000 require at least three informal (oral) bids, and purchase orders over \$1,000 require formal (written) bids.

These purchasing policies and procedures were not being followed. Purchase requisitions were never completed. Certain high-dollar vouchers related to significant vendors were reviewed, and testwork revealed the following other errors:

- Eighty-eight of 130 invoices (68%) were not supported by a purchase order.
- Of the 42 purchase orders that were available, three purchases orders (7%) were not completed with any quantity or price information as required by the policy.
- Two of the 42 purchase orders (5%) were dated after the services were rendered, indicating the purchase order was not approved prior to purchase.
- Eighteen of the 42 purchase orders (43%), including the two that were dated after the services were rendered, were not properly approved.
- Purchases with 23 of 31 vendors requiring bids (74%) were not supported by bid documentation.

Failure to follow purchasing and cash disbursement policies and procedures could result in fraud, abuse, or waste.

Service contracts are still not being obtained and sent to the Commissioner of the Tennessee Department of Finance and Administration for approval. For 10 of 14 service vendors tested in Murfreesboro (71%) and 3 of 7 service vendors tested in Humboldt (43%), a service contract could not be provided. In addition, one of 7 service vendors (14%) in Humboldt and one of 14 service vendors (7%) in Murfreesboro tested had contracts; however, purchases were made prior to the approval of the contracts. Section 58-7-103, *Tennessee Code Annotated*, states, "Contracts for services must also be approved in advance pursuant to Section 12-4-109." Properly approved contracts for services are necessary to ensure all parties are aware of the duties and responsibilities of each party and to ensure that agreements are in the best interest of the state.

As previously mentioned, management did adopt a new purchasing policy as of August 1, 2002. This new policy eliminates the requirement of purchase requisitions and eliminates the need for a purchase order if a standing contract exists. However, the related cash disbursement policy still requires a purchase order for all disbursements. This contradictory language may create confusion regarding documentation requirements.

Recommendation

The Administrator at each facility should ensure that purchasing duties are adequately segregated. The Executive Director should communicate that invoices created by employees will not be accepted as support for payments. Properly completed purchase orders should be approved before purchase for all applicable payments, and the Executive Director should take steps to ensure that the purchase order policies are not circumvented. Service contracts should be established and approved in accordance with state law. In addition, the board should make policy changes as necessary to ensure that purchasing and cash disbursement policies are not contradictory.

Management's Comment

We concur that for the period of the audit, adequate segregation for duties related to purchasing was not always available. The Board's policies and procedures over purchasing are being reviewed, and will be revised, if necessary. We are working with our liaison to the State Comptroller's office to insure proper segregation of duties or require a compensatory review by a superior staff person in the event that sufficient staffing is not available to allow for total segregation of duties.

We also concur that service contract approvals had not been properly obtained. Because of the number of services provided to our nursing homes, this has proven to be a somewhat overwhelming task. Board staff, with the advice and assistance of our liaison to the State Comptroller's office has indeed begun the contract review process. As part of this process, services are to be clearly identified and organized into type of contract required, and again, because of the large number of services that are provided, we are looking at possible methods available to streamline the task of developing the required contracts. As this is completed, a timeline will be developed for bringing service contracts into compliance with state regulations and Board policy, so although it will take some time to accomplish this project, we anticipate measurable progress to be shown by the end of the current fiscal year.

12. Improper employer/employee relationships and potential conflicts of interest were noted

Finding

The Humboldt facility has established improper employer/employee relationships with independent contractors and created potential conflicts of interest. At least two different individuals have served in the capacity of an assistant in the maintenance department since March 2002. This position is not one established by the board's budget, and any action to establish these individuals as formal employees of the board was not completed. Instead, they were acting as independent contractors. However, the following characteristics of the

relationship between the board and these contractors indicate these individuals were acting as state employees.

- The contractors performed the same functions as state employees. They performed tasks that would have otherwise been performed by the maintenance department employees.
- The maintenance director assigned all tasks and responsibilities of these individuals. Ultimately, the maintenance director and another maintenance employee, both board employees, supervised the contractors.
- The maintenance director stated that the individuals were brought in to work on specific projects. However, if the weather prevented work on those projects, other projects not contingent upon the weather were found.
- As there was no written contract with any of the individuals, the board retained the right of termination for any reason at any time.
- The contractors used board tools and equipment.
- During the two months of audit fieldwork at the Humboldt facility, the individual who was working in this capacity at the time only missed two working days.

Allowing contractors to report directly to board employees in carrying out what can be construed as board business raises serious policy and legal issues.

If contractors are acting as employees, conflict of interest concerns must also be raised. Even though very few of the individual projects completed by these individuals were significant, the cumulative total of disbursements to these individuals exceeded \$17,000 between March 2002 and April 2003. One of the contractors was the son of the maintenance director; the other, a close friend of the family. Board policy prohibits one family member supervising another. The hiring of these individuals as contractors circumvented the personnel policies related to conflicts of interest.

Recommendation

The board should establish policies to ensure that improper employer/employee relationships are avoided. If necessary, individuals can be hired on an “as needed” basis through the personnel process. The board should also review the budget for the maintenance department and determine if an additional permanent position is necessary. Any individuals should be placed on the board’s payroll system through proper hiring procedures. The Executive Director should communicate expectations regarding the avoidance of conflicts of interest to all employees. Disciplinary action should be taken if such circumstances continue.

Management's Comment

We concur. This was corrected on August 1, 2003. The last check written to the individual identified as having an improper relationship as an independent contractor was dated July 18, 2003. The existing policy on conflict of interest will be followed. Administration will determine if additional policies are needed to preclude improper employer/employee relations. Administrators will determine the need for additional maintenance personnel and justify that need to the Board in the annual budget preparation process. The Executive Director has communicated expectations to staff regarding the avoidance of conflicts of interest.

13. For the fourth consecutive year, receipt of goods and services was not documented

Finding

As noted in the prior three audits, internal control for payables is not adequate. The board concurred with the prior findings, stating that the Administrators at each facility would ensure proper documentation. Subsequent to the fiscal year under audit, the board approved a policy regarding the receipting of materials. However, there was no policy during the audit period, and verification of receipt was still not consistently documented.

Eight of 44 disbursements tested for the year ended June 30, 2002, (18%) did not have an employee's initials or signature and date as evidence of receipt. If the receipt of goods and services is not documented and payments are made without proper documentation, the facility may not receive the proper quantity or the proper item, or it may pay for goods or services not received. Also, without record of the date of receipt, the establishment of year-end payables may be erroneous.

Recommendation

The Administrator at each facility should ensure that personnel receiving the goods or services comply with the policy requiring verification and documentation of receipt.

Management's Comment

We concur. Administrators ensured compliance on September 1, 2003, at Murfreesboro and November 1, 2003, at Humboldt.

14. Petty cash policies are still inadequate and are still not being followed

Finding

As noted in the prior two audits, the petty cash policy does not address what types of purchases can be made through petty cash funds. The policies and procedures that have been adopted are not being followed. In response to the prior audit finding, the board indicated that petty cash policies would be revised to include what types of purchases are appropriate. In addition, management indicated that Administrators would ensure compliance with petty cash policies. However, many of the problems that existed with the former policy were not remedied with the revised policy. In addition, the policy does not require adequate internal control over petty cash.

The revised petty cash policy mentioned by the board in response to the prior finding was adopted as of August 2, 2001. The revised policy still does not provide guidance as to the types of purchases for which petty cash may be used, and there are no guidelines specifying what is an allowable petty cash expense. At Humboldt during the audit period, petty cash was used to make a donation to the local Chamber of Commerce and to reward the employee of the month with a \$25 cash prize. At Murfreesboro, petty cash was used to purchase several meals at local restaurants, to pay dues to a civic organization for an employee of the management company, and to replenish the Resident Trust Fund petty cash for a shortfall during the audit period. Although board personnel may consider all of these items to be allowable expenses, the use of the petty cash fund allows employees to avoid additional approvals. Without policies identifying allowable expenses, the petty cash could be used for activities that are outside the mission of the board.

In addition, the policy does not address the process for altering a petty cash receipt, the method of recording the expense account for the purchase, or the need for signatures of the custodian and the receiver of the petty cash. Without the requirement of the receiver initialing an alteration of information such as the amount on the petty cash receipt, the amounts could be altered by the person disbursing cash, increasing the risk of theft. As expense accounts were not consistently recorded on the receipts, several petty cash disbursements were expensed to the incorrect account. Nine out of 60 petty cash disbursements tested totaling \$268 (15%) were not recorded to the proper general ledger account. If signatures are not obtained from both the employee receiving reimbursement from the petty cash fund and the custodian disbursing such funds, a disbursement could be made without knowledge of the custodian as there is no prior approval required for petty cash disbursements. One instance was noted at the Murfreesboro facility in which "Left on desk" was written in the receiver line. There was no indication who actually received the cash. Another instance at Murfreesboro only had the signature of the employee who disbursed the funds. Once again, there was no indication of who received the funds. At the Humboldt facility, three items were noted that were only signed by the person receiving the funds. Without the signature of the person disbursing the funds, it is possible that the person disbursing the funds is the same individual as the one receiving the funds.

The petty cash policies and procedures that have been adopted were not followed. Formerly, policies and procedures indicated that petty cash disbursements should not exceed \$30 (policy covering July 1, 2001, to August 1, 2001), while the revised policies and procedures (subsequent to August 1, 2001) increased this limit to \$50. Purchases greater than these amounts must go through accounts payable. Two of 60 petty cash vouchers tested (3%) did not comply with these policies and exceeded the limit by as much as \$15. The policies do indicate that, with the Administrator's signature, emergency purchases may exceed the limit. However, these two purchases were for a meal at a local restaurant and the dues to a civic organization for an Administrator who was, at that time, an employee of the management company. These purchases do not appear to be emergency purchases.

In addition, both policies state that each disbursement must have a sales receipt to support withdrawals from petty cash. Five of 58 petty cash receipts tested (9%) did not have adequate sales receipts to support the withdrawals.

Both policies also state that cash advances for supplies must have the Administrator's signed approval and the employee must sign a receipt for money advanced. Upon the employee's return, the sales receipt is to be attached to the petty cash receipt with the exact amount of change returned noted on the petty cash receipt. Four of four petty cash disbursements that appeared to be advances (100%) did not have the appropriate information accompanying the petty cash receipts.

Both policies state a petty cash reconciliation form is to be used to document the replenishment of petty cash and this form is to be reviewed and documented by the Administrator. At Humboldt, no reconciliation form was utilized for petty cash replenishments. There was also no evidence of any type of reconciliation being performed. In addition to the reconciliations not being performed for the replenishment of petty cash, the petty cash replenishment amounts were not correct. At Murfreesboro, 3 out of 19 petty cash reimbursements (16%) were for different amounts than the sum of the applicable receipts. Included in that three is one reimbursement for petty cash that was for the amount of cash on hand, not for the total amount of the disbursements. In addition, the overages or shortages determined by reconciliations were not noted on a reconciliation worksheet.

The petty cash policies also state, "On a weekly basis the A/P clerk will request a check to replenish petty cash." Both facilities performed reimbursements at various times. The Murfreesboro facility appeared to perform reimbursements on a monthly basis. The basis on which the Humboldt facility reimbursed petty cash could not be determined. The time between reimbursements ranged from two days to approximately a month.

These policies were implemented to establish internal control over petty cash. Petty cash disbursements for the year totaled approximately \$8,000. When the policies are not followed, the fund may be used for purposes for which it was not intended. Without proper reconciliations and replenishments, errors and irregularities within the fund could occur and go unnoticed.

Recommendation

The board should promptly modify the petty cash policy to include guidance for the types of appropriate petty cash purchases. The policy should also address receipt alterations, coding of expense accounts, and signature requirements for disbursements. The Administrators should ensure that existing petty cash policies and procedures are followed. The Executive Director should take action to ensure that reasonable controls are in place related to the petty cash fund. Employees should not use the petty cash fund to avoid obtaining approvals that would otherwise be required for potentially questionable expenses. Reconciliations should be performed and reviewed before replenishment. Overages and shortages should be documented and large differences investigated.

Management's Comment

We concur. The Board adopted a new policy on February 27, 2003, that addresses "Appropriate Reimbursements Items." The Board will review the recommendations provided by the auditors for inclusion in the existing policy.



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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JAMES K. POLK STATE OFFICE BUILDING
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Independent Auditor's Report

July 11, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We were engaged to audit the accompanying statement of net assets of the Tennessee State Veterans' Homes Board, a component unit of the State of Tennessee, as of June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the board's management.

Certain records and documentation supporting transactions and account balances were not available for our audit. Other records have not been adequately maintained. Therefore, we were not able to satisfy ourselves about the amounts at which cash, accounts receivable, furniture and equipment, and accounts payable are recorded at June 30, 2002, and the amounts of expenses and revenues for the year ended June 30, 2002.

Because of the significance of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to in the first paragraph.

The Tennessee State Veterans' Homes Board has not presented the management's discussion and analysis that accounting principles generally accepted in the United States of America have determined is necessary to supplement, although not required to be part of, the basic financial statements. The schedule of Pension Funding Progress on page 71 is not a required part of the basic financial statements but is supplementary information also required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the

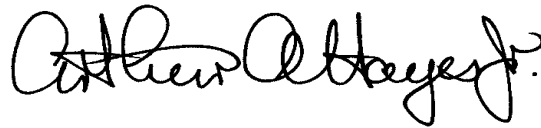
The Honorable John G. Morgan
July 11, 2003
Page Two

methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The accompanying financial information on pages 72 through 77 is presented for purposes of additional analysis and is not a required part of the basic financial statements. We did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 11, 2003, on our consideration of the board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." in a cursive script.

Arthur A. Hayes, Jr., CPA,
Director

AAH/kja

UNAUDITED

Exhibit A

**Tennessee State Veterans' Homes Board
Statement of Net Assets
June 30, 2002**

Assets:

Current assets:

Cash (Note 2)	\$ 2,014,248.11
Investments (Note 2)	27,786.07
Resident accounts receivable, net of allowance for doubtful accounts of \$1,463,431.13 (Note 3)	517,959.44
Due from primary government (Note 4)	87,163.63
Medicare cost settlement receivable	274,708.76
Inventories	50,176.50
Prepaid items	81,117.77
Restricted cash (Notes 2, 5)	353,787.91

Total current assets	<u>3,406,948.19</u>
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Noncurrent assets:

Restricted cash (Notes 2, 5)	1,116,624.47
Unamortized bond issuance costs	105,114.59
Capital assets (Note 6):	
Land	194,244.00
Infrastructure	734,196.00
Accumulated depreciation-infrastructure	(224,984.27)
Buildings and improvements	10,330,008.66
Accumulated depreciation - buildings and improvements	(2,105,298.78)
Furniture and equipment	1,754,942.28
Accumulated depreciation - furniture and equipment	<u>(1,101,914.58)</u>

Total noncurrent assets	<u>10,802,932.37</u>
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Total assets	<u>14,209,880.56</u>
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UNAUDITED

Exhibit A (Cont.)

Tennessee State Veterans' Homes Board
Statement of Net Assets
June 30, 2002

Liabilities:

Current liabilities:

Accounts payable and accruals (Note 7)	971,706.10
Due to primary government (Note 4)	341,262.46
Checks payable	12,558.27
Amounts held in custody for others	129,933.42
Medicaid current financing	169,599.64
Bonds payable (Note 8)	170,000.00
Loan from the State of Tennessee	20,000.00

Total current liabilities	<u>1,815,059.89</u>
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Noncurrent liabilities:

Bonds payable, net of unamortized discount (Note 8)	4,397,404.20
Loan from the State of Tennessee (Note 8)	140,000.00

Total noncurrent liabilities	<u>4,537,404.20</u>
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Total liabilities	<u>6,352,464.09</u>
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Net Assets:

Invested in capital assets, net of related debt	4,853,789.11
Restricted for:	
Debt service	607,359.45
Repairs and replacements	600,124.64
Unrestricted	1,796,143.27

Total net assets	<u>\$ 7,857,416.47</u>
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The notes to the financial statements are an integral part of this statement.

Tennessee State Veterans' Homes Board
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2002

Operating revenue:

Resident service revenue less contractual adjustments of \$464,161.83 and bad debts of \$282,679.91	\$ <u>11,508,113.38</u>
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Total operating revenue	<u>11,508,113.38</u>
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Operating expenses:

Administrative and general	2,009,430.68
Nursing services	4,978,526.02
Central services	280,574.29
Ancillary departments	1,053,788.21
Dietary	935,282.44
Activities	166,556.06
Social services	148,238.58
Housekeeping services	436,431.48
Laundry and linens	225,712.03
Plant operations and maintenance	625,150.32
Depreciation	<u>410,243.57</u>

Total operating expenses	<u>11,269,933.68</u>
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Operating income	<u>238,179.70</u>
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UNAUDITED

Exhibit B (Cont.)

Tennessee State Veterans' Homes Board
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2002

Nonoperating revenues (expenses):

Interest revenue	75,951.31
Miscellaneous revenue	29,375.21
Interest expense	(328,004.44)
Amortization of discounts and issuance costs	(8,846.88)
Loss on disposal of equipment	(13,291.37)
Miscellaneous expense	<u>(24,094.37)</u>
Total nonoperating revenues (expenses)	<u>(268,910.54)</u>
Decrease in net assets	(30,730.84)
Net Assets, July 1	<u>7,888,147.31</u>
Net Assets, June 30	<u><u>\$ 7,857,416.47</u></u>

The notes to the financial statements are an integral part of this statement.

Tennessee State Veterans' Homes Board
Statement of Cash Flows
For the Year Ended June 30, 2002

Cash flows from operating activities:

Receipts from residents and third party payors	\$ 12,113,570.11
Other miscellaneous receipts	3,081.66
Payments to service providers and vendors	(4,594,458.41)
Payments to employees	(6,298,962.37)
Other miscellaneous payments	(10,535.81)

Net cash provided by operating activities	<u>1,212,695.18</u>
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Cash flows from noncapital financing activities:

Principal paid on loan from the State of Tennessee	(10,000.00)
Negative cash balance implicitly financed	12,558.27
Foundation donations	25,474.39
Expenses paid by the foundation	(23,876.26)

Net cash provided by noncapital financing activities	<u>4,156.40</u>
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Cash flows from capital and capital-related financing activities:

Purchase of capital assets	(146,874.57)
Principal paid on bonds	(165,000.00)
Interest paid on bonds	(330,111.60)

Net cash used for capital and capital-related financing activities	<u>(641,986.17)</u>
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Cash flows from investing activities:

Interest received	<u>74,527.96</u>
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Net cash provided by investing activities	<u>74,527.96</u>
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Net increase in cash	649,393.37
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Cash, July 1	<u>2,835,267.12</u>
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Cash, June 30	<u><u>\$ 3,484,660.49</u></u>
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UNAUDITED

Exhibit C (Cont.)

**Tennessee State Veterans' Homes Board
Statement of Cash Flows
For the Year Ended June 30, 2002**

**Reconciliation of operating income to net cash
provided by operating activities:**

Operating income	\$ <u>238,179.70</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	410,243.57
Decrease in net resident accounts receivable	418,005.58
Increase in due from primary government	(87,163.63)
Decrease in amounts advanced by management company	78,750.39
Decrease in Medicare cost settlement receivable	18,138.34
Decrease in inventories	10,884.67
Decrease in prepaid items	10,422.02
Increase in noncapital accounts payable and accruals	121,668.24
Decrease in due to primary government	(43,312.47)
Decrease in amounts held in custody for others	(7,454.15)
Increase in Medicaid current financing	<u>44,332.92</u>
Total adjustments	<u>974,515.48</u>
Net cash provided by operating activities:	\$ <u><u>1,212,695.18</u></u>

The notes to the financial statements are an integral part of this statement.

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements
June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Tennessee State Veterans' Homes Board was established in 1988 under the provisions of Title 58, Chapter 7, *Tennessee Code Annotated*. This statute authorizes the creation of public homes for veterans throughout the state to provide support and care for honorably discharged veterans who served in the United States armed forces. At June 30, 2002, two facilities, located in Murfreesboro and Humboldt, were operating. The ten-member board has appointed an executive director to carry out its operations.

The Tennessee State Veterans' Homes Board is a component unit of the State of Tennessee (the primary government). Although it is a separate legal entity, the board is appointed by the Governor, and its budget is approved by the state. In addition, the issuance of bonds must be approved by the State Funding Board. The board is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

The Tennessee Veterans Home Foundation, Inc., was established by the Tennessee State Veterans' Homes Board to receive donations for the benefit of the facilities' residents. The foundation Board of Directors has 11 members, 6 of which are appointed by the Tennessee State Veterans' Homes Board. The board was developed solely to benefit the residents of Tennessee State Veterans' Homes. Due to this relationship, the foundation is included in the board's financial statements.

B. Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Tennessee State Veterans' Homes Board follows applicable GASB pronouncements, as well as applicable private-sector pronouncements issued on or before November 30, 1989.

C. Measurement Focus and Basis of Accounting

The financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under the

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

accrual basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Tennessee State Veterans' Homes Board distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with principal ongoing operations. The board's principal operation is to provide support and care for honorably discharged veterans who served in the United States armed services. Any revenues and expenses not meeting this definition would be reported as nonoperating revenues and expenses.

When the board has both restricted and unrestricted resources available to finance a particular activity, it is the board's policy to use restricted resources before unrestricted resources.

D. Cash

Cash is defined as cash on hand and demand deposits. In addition to petty cash, facility bank accounts, and foundation bank accounts, cash includes funds held with a trustee. The unrestricted portion of the trustee funds includes funds available for use for board operations through the budget process.

E. Investments

The investments are certificates of deposit which are stated at cost.

F. Inventories

Inventories of medical, dietary, and housekeeping supplies are determined by physical count and are valued at replacement cost. This valuation is not materially different from historical cost.

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

G. Restricted Assets

Certain assets of the Tennessee State Veterans' Homes Board are classified as restricted assets because their use is restricted by applicable bond covenants. Other assets are the property of the homes' residents and are likewise classified as restricted assets.

H. Capital Assets and Depreciation

Capital assets are defined as assets with a useful life of at least 2 years and with a value of at least \$500. Capital assets are recorded at cost and are depreciated on a straight-line basis over the estimated useful lives of the assets. Donated capital assets are stated at fair value at the date of donation. The board's policy is to capitalize interest expense incurred during the construction of assets. All capital assets other than land are depreciated using the straight-line method using these asset lives:

Infrastructure	8 to 40 years
Buildings and building improvements	5 to 40 years
Furniture and equipment	3 to 20 years

I. Checks Payable

This amount represents the sum of checks written in excess of the board's checking account balance.

J. Bond Discounts and Issuance Costs

Bond discounts and issuance costs are deferred and amortized over the life of the bonds using the straight-line method. The results of this method are not materially different from those of the effective interest method. Bonds payable are reported net of unamortized bond discount.

K. New Accounting Pronouncement

Effective July 1, 2001, the board adopted GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. To conform to the requirements of GASB 34, the following changes have been made to the board's financial statements:

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

- A. Retained earnings have been classified into the following categories of Net Assets – invested in capital assets, net of related debt; restricted; and unrestricted.
- B. The statement of financial position is now presented in a statement of net assets format rather than a balance sheet format.

An additional component of GASB Statement No. 34 which the board has not adopted is the inclusion of Management's Discussion and Analysis as required supplementary information.

NOTE 2. DEPOSITS

At June 30, 2002, the carrying amount of the board's deposits was \$1,122,043.10, and the bank balance was \$1,347,269.76. The entire bank balance was considered insured by FDIC or was in financial institutions that participate in the bank collateral pool administered by the Treasurer of the State of Tennessee. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

The board also had \$2,388,353.46 deposited in the Local Government Investment Pool (LGIP) administered by the State Treasurer and \$2,050 of petty cash on hand. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 3. ACCOUNTS RECEIVABLE

Receivables at June 30, 2002, consist of the following:

Receivables from patients and their insurance	\$1,475,496.83
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UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

Receivable from Medicare	449,985.14
Receivable from U.S. Department of Veterans Affairs	55,908.60
Allowance for doubtful accounts	<u>(1,463,431.13)</u>
Net amount reported as resident accounts receivable	<u>\$ 517,959.44</u>

The net receivable amount of \$517,959.44 represents accounts receivable that are expected to be collected within one year.

NOTE 4. DUE FROM/TO PRIMARY GOVERNMENT

Due From:

Department of Finance and Administration—Medicaid current services less void adjustments	<u>\$ 87,163.63</u>
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Total due from primary government	<u>\$ 87,163.63</u>
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Due To:

Department of Finance and Administration—Medicaid overpayments occurring before 1994	\$ 282,062.42
Department of Health – bed tax	44,500.00
Department of the Treasury—retirement contributions	12,996.81
Department of Labor and Workforce Development—unemployment taxes	957.27
Department of Labor and Workforce Development – boiler inspection fees	60.00
Department of Human Services – child support payments	491.76
Office of the Attorney General – legal fees	<u>194.20</u>

Total due to primary government	<u>\$ 341,262.46</u>
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The amount Due from Primary Government, Department of Finance and Administration—Medicaid current services less void adjustments, includes both the receivable for amounts collectible from Medicaid for current services, and a payable to Medicaid for void adjustments that may be related to previous services. At June 30, 2002, the receivable from Medicaid is \$637,687.46, and the estimated payable to Medicaid for void adjustments is \$550,523.83.

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

The amount Due to Primary Government, Department of Finance and Administration–Medicaid overpayments occurring before 1994, consists of \$282,062.42 payable for Medicaid overpayments made prior to the implementation of the void adjustment process.

NOTE 5. RESTRICTED ASSETS

The balances of the board's restricted asset accounts at June 30, 2002, are as follows:

Resident trust fund accounts	\$129,933.42
Revenue bond debt service accounts	223,854.49
Revenue bond debt service reserve accounts	516,499.83
Revenue bond repair and replacement accounts	<u>600,124.64</u>
Total restricted assets	<u>\$1,470,412.38</u>

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2002 was as follows:

	Beginning	Additions	Retirements	Ending
Capital assets, not being depreciated:				
Land	<u>\$194,244.00</u>	<u>-</u>	<u>-</u>	<u>\$194,244.00</u>
Capital assets, being depreciated:				
Infrastructure	734,196.00	-	-	734,196.00
Buildings and improvements	10,316,507.40	13,501.26	-	10,330,008.66
Furniture and equipment	<u>1,690,981.90</u>	<u>123,995.94</u>	<u>(60,035.56)</u>	<u>1,754,942.28</u>
Total depreciable capital assets	12,741,685.30	137,497.20	(60,035.56)	12,819,146.94
Less accumulated depreciation:				
Infrastructure	(197,767.07)	(27,217.20)	-	(224,984.27)

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

Buildings and improvements	(1,834,640.23)	(270,658.55)	-	(2,105,298.78)
Furniture and equipment	<u>(1,036,290.95)</u>	<u>(112,367.82)</u>	<u>46,744.19</u>	<u>(1,101,914.58)</u>
Total accumulated depreciation	<u>(3,068,698.25)</u>	<u>(410,243.57)</u>	<u>46,744.19</u>	<u>(3,432,197.63)</u>
Total depreciable capital assets, net	<u>9,672,987.05</u>	<u>(272,746.37)</u>	<u>(13,291.37)</u>	<u>9,386,949.31</u>
Net capital assets	<u>\$9,867,231.05</u>	<u>(272,746.37)</u>	<u>(13,291.37)</u>	<u>\$9,581,193.31</u>

NOTE 7. ACCOUNTS PAYABLE AND ACCRUALS

Payables at June 30, 2002, consist of the following:

Payables to suppliers	\$ 337,525.94
Accruals for salaries and benefits	501,185.29
Accrued interest	<u>132,994.87</u>
Amount reported as accounts payable and accruals	<u>\$ 971,706.10</u>

NOTE 8. LONG TERM LIABILITIES

Long term debt activity for the year ended June 30, 2002 was as follows:

	Beginning	Additions	Reductions	Ending
Bonds payable:				
Series 1989	\$1,749,077.27	-	(\$92,939.96)	\$1,656,137.31
Series 1994	<u>2,815,796.97</u>	<u>-</u>	<u>(74,530.08)</u>	<u>2,741,266.89</u>
Total	4,564,874.24	-	(167,470.04)	4,397,404.20
Loan from the State of Tennessee	<u>150,000.00</u>	<u>-</u>	<u>(10,000.00)</u>	<u>140,000.00</u>
Total long term liabilities	<u>\$4,714,874.24</u>	<u>-</u>	<u>(177,470.04)</u>	<u>\$4,537,404.20</u>

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

The board received a \$200,000 loan from the State of Tennessee to be repaid from excess revenues from the operations of the Murfreesboro facility. No interest is accrued. Payments of \$10,000 are made yearly. The \$10,000 due for the year ended June 30, 2002, was not paid until July 2002.

Total bonds payable consisted of the following:

	<u>June 30, 2002</u>
Revenue bonds, Series 1989, 6.3% to 7.5% due from 2002 to final maturity in 2014 (net of unamortized discount of \$23,862.69 for 2002)	\$1,751,137.31
Revenue bonds, Series 1994, 4.75% to 6.75% due from 2002 to final maturity in 2021 (net of unamortized discount of \$8,733.11 for 2002)	<u>2,816,266.89</u>
Total bonds payable	<u><u>\$4,567,404.20</u></u>

Debt-service requirements to maturity of the bonds payable at June 30, 2002, are as follows:

For the Year(s) <u>Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2003	\$ 170,000.00	\$ 319,187.50	\$ 489,187.50
2004	180,000.00	307,807.50	487,807.50
2005	210,000.00	295,612.50	505,612.50
2006	220,000.00	281,472.50	501,472.50
2007	230,000.00	266,492.50	496,492.50
2008 – 2112	1,430,000.00	1,063,147.50	2,493,147.50
2113 – 2117	1,260,000.00	530,737.50	1,790,737.50
2118 – 2021	900,000.00	156,937.50	1,056,937.50
	<u><u>\$4,600,000.00</u></u>	<u><u>\$3,221,395.00</u></u>	<u><u>\$7,821,395.00</u></u>

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

NOTE 9. DEFINED BENEFIT PENSION PLAN

A. Plan Description

Employees of Tennessee State Veterans' Homes Board are members of the Political Subdivision Pension Plan (PSPP), an agent multiple-employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with 5 years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members at the age of 55 or at any age with 25 years of service. Disability benefits are available to active members with five years of service who became disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the system after July 1, 1979, become vested after five years of service, and members joining prior to July 1, 1979, were vested after four years of service. Benefit provisions are established in state statute found in Title 8, Chapters 34-37, *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly. Political subdivisions such as Tennessee State Veterans' Homes Board participate in the TCRS as individual entities and are liable for all costs associated with the operation and administration of their plan. Benefit improvements are not applicable to a political subdivision unless approved by the chief governing body.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for the PSPP. That report may be obtained by writing to the Tennessee Treasury Department, Consolidated Retirement System, 10th Floor, Andrew Jackson Building, Nashville, Tennessee 37243-0230, or the report can be accessed at www.treasury.state.tn.us.

B. Funding Policy

The Tennessee State Veterans' Homes Board has adopted a noncontributory retirement plan for its employees.

The Tennessee State Veterans' Homes Board is required to contribute at an actuarially determined rate; the rate for the fiscal year ending June 30, 2002, was 7.98% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for the board is established and may be amended by the TCRS' Board of Trustees.

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

C. Annual Pension Cost

For the year ended June 30, 2002, Tennessee State Veterans' Homes Board's annual pension cost of \$291,991 to TCRS was equal to the board's required and actual contributions. The required contribution was determined as part of the June 30, 1999, actuarial valuation using the frozen initial liability actuarial cost method. Significant actuarial assumptions used in the valuation include (a) rate of return on investment of present and future assets of 7.5% a year compounded annually, (b) projected salary increases of 5.5% annual rate (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries), (c) projected 4.5% annual increase in the social security wage base, and (d) projected post retirement benefit increases of 3% annually. The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the market value of total investments over a five-year period.

Three-Year Trend Information

<u>Fiscal Year</u> <u>Ending</u>	<u>Annual Pension</u> <u>Cost (APC)</u>	<u>Percentage of APC</u> <u>Contributed</u>	<u>Net Pension</u> <u>Obligation</u>
June 30, 2002	\$291,991	100.00%	-
June 30, 2001	\$253,967	100.00%	-
June 30, 2000	\$226,876	100.00%	-

NOTE 10. RISK MANAGEMENT

The board is exposed to various risks of loss related to general liability; automobile liability; professional malpractice; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters.

- A. The building and contents are insured by the State of Tennessee. The board has scheduled coverage of \$10,494,200 for the buildings and \$1,575,600 for the contents.

The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

employees. The insurance policy deductibles vary from \$1 million to \$5 million by type of risk coverage. Based on past experience, a designation of \$5 million for deductibles and \$1.356 million for incurred losses has been established in the State of Tennessee general fund to provide for any property losses other than the commercial insurance coverage.

- B. The board participates in the State of Tennessee's Claims Award Fund, an internal service fund in which the state has set aside assets for claims settlement. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the participating agencies based on a percentage of each agency's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year-end to determine the fund liability and premium allocation.
- C. The board has elected to provide health coverage for its employees through a health plan for eligible local governments and quasi-governmental agencies in Tennessee. The Local Government Group Insurance Fund provides access to affordable health insurance by pooling risk among the groups. The plan provides for greater stability in controlling premium increases and, through a structured managed-care program, helps contain health care costs of participating members.

The plan is administered by the State of Tennessee, using a separately established fund. Premiums of participating units are deposited to this fund and used to pay claims for health care costs of participants, as well as the state's administrative costs of the plan. Employees have the option of obtaining insurance through either BlueCross BlueShield of Tennessee or Aetna Insurance. Claims are administered by these companies, which are currently under contract to provide these and other services to the state. Insurance premiums are adjusted at the end of the year based on the claims experience of the pool. Individual pool participants are not assessed additional premiums based on individual claims experience. Employees and providers have 13 months to file medical claims under BlueCross BlueShield of Tennessee and Aetna.

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements (Cont.)
June 30, 2002

NOTE 11. SUBSEQUENT EVENTS

The State of Tennessee has refunded both the Revenue bonds, Series 1989 and the Revenue bonds, Series 1994 with General Obligation bonds 2003 Series A on September 11, 2003. As a result, the Tennessee State Veterans' Homes Board has a loan payable to the State of Tennessee for the amounts previously reported as bonds payable.

The addition of a third facility in East Tennessee has been proposed.

UNAUDITED
Tennessee State Veterans' Homes Board
Required Supplementary Information
Schedule of Pension Funding Progress

(Expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
7/01/01	\$1,780	\$1,780	\$0	100%	\$3,048	0%
7/01/99	1,134	1,134	0	100%	2,022	0%
6/30/97	645	645	0	100%	2,191	0%

Changes in Actuarial Assumptions

An actuarial valuation was performed as of July 1, 2001, to establish contribution rates as of July 1, 2002. The July 1, 1999, actuarial valuation established contribution rates for the year ended June 30, 2002. Significant actuarial assumptions used in both valuations included a rate of return on investment of present and future assets of 7.5 % a year compounded annually and a projected annual increase in post-retirement benefits of 3% of the retiree's most recent benefit. Projected salary increases used in the 2001 valuation were 4.75% a year compounded annually, down from 5.5% a year in the 1999 valuation (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries). The 2001 valuation projected a 3.5% annual increase in the social security wage base, down from 4.5 % in the 1999 valuation.

UNAUDITED
Tennessee State Veterans' Homes Board
Supplementary Statements of Net Assets
June 30, 2002

	<u>Murfreesboro</u>	<u>Humboldt</u>	<u>Foundation</u>	<u>Totals</u>
Assets:				
Current assets:				
Cash	\$ 717,121.29	\$ 1,263,588.66	\$ 33,538.16	\$ 2,014,248.11
Investments	-	-	27,786.07	27,786.07
Resident accounts receivable, net of allowance for doubtful accounts of \$1,463,431.13	310,585.00	207,374.44	-	517,959.44
Due from primary government	88,672.00	(1,508.37)	-	87,163.63
Medicare cost settlement receivable	44,905.97	229,802.79	-	274,708.76
Due from Humboldt facility	150,492.32	-	-	150,492.32
Inventories	19,727.81	30,448.69	-	50,176.50
Prepaid items	40,477.50	40,640.27	-	81,117.77
Restricted cash	150,262.01	203,525.90	-	353,787.91
Total current assets	<u>1,522,243.90</u>	<u>1,973,872.38</u>	<u>61,324.23</u>	<u>3,557,440.51</u>
Noncurrent assets:				
Restricted cash	708,277.10	408,347.37	-	1,116,624.47
Unamortized bond issuance costs	20,316.08	84,798.51	-	105,114.59
Capital assets:				
Land	33,700.00	160,544.00	-	194,244.00
Infrastructure	172,245.00	561,951.00	-	734,196.00
Accumulated depreciation-infrastructure	(109,670.22)	(115,314.05)	-	(224,984.27)
Buildings and improvements	3,959,242.22	6,370,766.44	-	10,330,008.66
Accumulated depreciation - buildings and improvements	(1,073,265.46)	(1,032,033.32)	-	(2,105,298.78)
Furniture and equipment	889,664.57	865,277.71	-	1,754,942.28
Accumulated depreciation - furniture and equipment	(645,822.82)	(456,091.76)	-	(1,101,914.58)
Total noncurrent assets	<u>3,954,686.47</u>	<u>6,848,245.90</u>	<u>-</u>	<u>10,802,932.37</u>
Total assets	<u>5,476,930.37</u>	<u>8,822,118.28</u>	<u>61,324.23</u>	<u>14,360,372.88</u>

UNAUDITED
Tennessee State Veterans' Homes Board
Supplementary Statements of Net Assets (Cont.)
June 30, 2002

	<u>Murfreesboro</u>	<u>Humboldt</u>	<u>Foundation</u>	<u>Totals</u>
Liabilities:				
Current liabilities:				
Accounts payable and accruals	472,467.20	499,020.79	218.11	971,706.10
Due to primary government	317,912.17	23,350.29	-	341,262.46
Checks payable	12,558.27	-	-	12,558.27
Amounts held in custody for others	35,783.49	94,149.93	-	129,933.42
Medicaid current financing	99,936.69	69,662.95	-	169,599.64
Due to Murfreesboro facility	-	150,492.32	-	150,492.32
Bonds payable	95,000.00	75,000.00	-	170,000.00
Loan from the State of Tennessee	20,000.00	-	-	20,000.00
Total current liabilities	<u>1,053,657.82</u>	<u>911,676.28</u>	<u>218.11</u>	<u>1,965,552.21</u>
Noncurrent liabilities:				
Bonds payable, net of unamortized discount	1,656,137.31	2,741,266.89	-	4,397,404.20
Loan from the State of Tennessee	140,000.00	-	-	140,000.00
Total noncurrent liabilities	<u>1,796,137.31</u>	<u>2,741,266.89</u>	<u>-</u>	<u>4,537,404.20</u>
Total liabilities	<u>2,849,795.13</u>	<u>3,652,943.17</u>	<u>218.11</u>	<u>6,502,956.41</u>
Net Assets:				
Invested in capital assets, net of related debt	1,314,955.98	3,538,833.13	-	4,853,789.11
Restricted for:				
Debt service	295,752.19	311,607.26	-	607,359.45
Repairs and replacements	471,888.83	128,235.81	-	600,124.64
Unrestricted	544,538.24	1,190,498.91	61,106.12	1,796,143.27
Total net assets	<u>\$ 2,627,135.24</u>	<u>\$ 5,169,175.11</u>	<u>\$ 61,106.12</u>	<u>\$ 7,857,416.47</u>

UNAUDITED
Tennessee State Veterans' Homes Board
Supplementary Statements of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2002

	<u>Murfreesboro</u>	<u>Humboldt</u>	<u>Foundation</u>	<u>Totals</u>
Operating revenue:				
Resident service revenue less contractual adjustments of \$464,161.83 and provision for bad debts of \$282,679.91	\$ 5,878,245.92	\$ 5,629,867.46	\$ -	\$ 11,508,113.38
Total operating revenue	<u>5,878,245.92</u>	<u>5,629,867.46</u>	<u>-</u>	<u>11,508,113.38</u>
Operating expenses:				
Administrative and general	1,011,199.78	998,230.90	-	2,009,430.68
Nursing services	2,711,889.30	2,266,636.72	-	4,978,526.02
Central services	124,257.32	156,316.97	-	280,574.29
Ancillary departments	516,852.16	536,936.05	-	1,053,788.21
Dietary	502,448.65	432,833.79	-	935,282.44
Activities	90,531.64	76,024.42	-	166,556.06
Social services	91,949.62	56,288.96	-	148,238.58
Housekeeping services	214,069.91	222,361.57	-	436,431.48
Laundry and linens	112,053.97	113,658.06	-	225,712.03
Plant operations and maintenance	320,259.19	304,891.13	-	625,150.32
Depreciation	<u>165,773.56</u>	<u>244,470.01</u>	<u>-</u>	<u>410,243.57</u>
Total operating expenses	<u>5,861,285.10</u>	<u>5,408,648.58</u>	<u>-</u>	<u>11,269,933.68</u>
Operating income	<u>16,960.82</u>	<u>221,218.88</u>	<u>-</u>	<u>238,179.70</u>

UNAUDITED
Tennessee State Veterans' Homes Board
Supplementary Statements of Revenues, Expenses, and Changes in Net Assets (Cont.)
For the Year Ended June 30, 2002

	<u>Murfreesboro</u>	<u>Humboldt</u>	<u>Foundation</u>	<u>Totals</u>
Nonoperating revenue (expenses):				
Interest revenue	24,537.89	49,423.79	1,989.63	75,951.31
Miscellaneous revenue	1,372.99	2,527.83	25,474.39	29,375.21
Interest expense	(137,457.52)	(190,546.92)	-	(328,004.44)
Amortization of discounts and issuance costs	(3,813.84)	(5,033.04)	-	(8,846.88)
Equipment donation	6,854.64	3,911.00	-	10,765.64
Equipment expense	-	-	(10,765.64)	(10,765.64)
Loss on disposal of equipment	-	(13,291.37)	-	(13,291.37)
Miscellaneous expense	-	-	(24,094.37)	(24,094.37)
Total nonoperating revenues (expenses)	<u>(108,505.84)</u>	<u>(153,008.71)</u>	<u>(7,395.99)</u>	<u>(268,910.54)</u>
Increase (decrease) in net assets	(91,545.02)	68,210.17	(7,395.99)	(30,730.84)
Net assets, July 1	<u>2,718,680.26</u>	<u>5,100,964.94</u>	<u>68,502.11</u>	<u>7,888,147.31</u>
Net assets, June 30	<u>\$ 2,627,135.24</u>	<u>\$ 5,169,175.11</u>	<u>\$ 61,106.12</u>	<u>\$ 7,857,416.47</u>

UNAUDITED
Tennessee State Veterans' Homes Board
Supplementary Statements of Cash Flows
For the Year Ended June 30, 2002

	<u>Murfreesboro</u>	<u>Humboldt</u>	<u>Foundation</u>	<u>Totals</u>
Cash flows from operating activities:				
Receipts from residents and third party payors	\$ 5,912,876.89	\$ 6,200,693.22	\$ -	\$ 12,113,570.11
Other miscellaneous receipts	-	3,081.66	-	3,081.66
Payments to service providers and vendors	(2,191,051.23)	(2,403,407.18)	-	(4,594,458.41)
Payments to employees	(3,475,139.71)	(2,823,822.66)	-	(6,298,962.37)
Other miscellaneous payments	(10,535.81)	-	-	(10,535.81)
Net cash provided by operating activities	<u>236,150.14</u>	<u>976,545.04</u>	<u>-</u>	<u>1,212,695.18</u>
Cash flows from noncapital financing activities:				
Principal paid on loan from the State of Tennessee	(10,000.00)	-	-	(10,000.00)
Negative cash balance implicitly financed	12,558.27	-	-	12,558.27
Foundation donations	-	-	25,474.39	25,474.39
Expenses paid by the foundation	-	-	(23,876.26)	(23,876.26)
Net cash provided by noncapital financing activities	<u>2,558.27</u>	<u>-</u>	<u>1,598.13</u>	<u>4,156.40</u>
Cash flows from capital and capital-related financing activities:				
Purchase of capital assets	(71,092.54)	(55,639.02)	(20,143.01)	(146,874.57)
Principal paid on bonds	(90,000.00)	(75,000.00)	-	(165,000.00)
Interest paid on bonds	(138,935.00)	(191,176.60)	-	(330,111.60)
Net cash used for capital and capital-related financing activities	<u>(300,027.54)</u>	<u>(321,815.62)</u>	<u>(20,143.01)</u>	<u>(641,986.17)</u>
Cash flows from investing activities:				
Interest received	<u>24,537.89</u>	<u>49,423.79</u>	<u>566.28</u>	<u>74,527.96</u>
Net cash provided by investing activities	<u>24,537.89</u>	<u>49,423.79</u>	<u>566.28</u>	<u>74,527.96</u>
Net increase (decrease) in cash	(36,781.24)	704,153.21	(17,978.60)	649,393.37
Cash, July 1	<u>1,612,441.64</u>	<u>1,171,308.72</u>	<u>51,516.76</u>	<u>2,835,267.12</u>
Cash, June 30	<u>\$ 1,575,660.40</u>	<u>\$ 1,875,461.93</u>	<u>\$ 33,538.16</u>	<u>\$ 3,484,660.49</u>

UNAUDITED
Tennessee State Veterans' Homes Board
Supplementary Statements of Cash Flows (Cont.)
For the Year Ended June 30, 2002

	<u>Murfreesboro</u>	<u>Humboldt</u>	<u>Foundation</u>	<u>Totals</u>
Reconciliation of operating income to net cash provided by operating activities:				
Operating income	\$ <u>16,960.82</u>	\$ <u>221,218.88</u>	\$ <u>-</u>	\$ <u>238,179.70</u>
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation	165,773.56	244,470.01	-	410,243.57
Decrease in net resident accounts receivable	123,332.96	294,672.62	-	418,005.58
(Increase) decrease in due from primary government	(88,672.00)	1,508.37	-	(87,163.63)
Decrease in amounts advanced by management company	43,867.15	34,883.24	-	78,750.39
(Increase) decrease in Medicare cost settlement receivable	22,578.95	(4,440.61)	-	18,138.34
Increase in due from Humboldt	(146,044.33)	-	-	(146,044.33)
(Increase) decrease in inventories	(3,601.26)	14,485.93	-	10,884.67
Decrease in prepaid items	573.55	9,848.47	-	10,422.02
Increase in noncapital accounts payable and accruals	53,876.36	67,791.88	-	121,668.24
Increase (decrease) in due to primary government	36,256.40	(79,568.87)	-	(43,312.47)
Increase (decrease) in amounts held in custody for others	(10,535.81)	3,081.66	-	(7,454.15)
Increase in Medicaid current financing	21,783.79	22,549.13	-	44,332.92
Increase in due to Murfreesboro	<u>-</u>	<u>146,044.33</u>	<u>-</u>	<u>146,044.33</u>
Total adjustments	<u>219,189.32</u>	<u>755,326.16</u>	<u>-</u>	<u>974,515.48</u>
Net cash provided by operating activities:	\$ <u><u>236,150.14</u></u>	\$ <u><u>976,545.04</u></u>	\$ <u><u>-</u></u>	\$ <u><u>1,212,695.18</u></u>